Reserve Bank of Australia
Annual Report

2017

RESERVE BANK
OF AUSTRALIA

RESERVE BANK OF AUSTRALIA

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25 August 2017

The Hon Scott Morrison MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

RESERVE BANK OF AUSTRALIA ANNUAL REPORT 2017

In accordance with section 46 of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), I am pleased to submit the Reserve Bank's Annual Report for 2017 for presentation to the Parliament. The annual report has been prepared in accordance with the rules under section 46(3) of the PGPA Act.

Yours sincerely

Philip Lowe

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This report is available electronically in PDF and HTML formats on the Reserve Bank's website:
<www.rba.gov.au/publications/annual-reports/rba/index.html>.

The Reserve Bank welcomes comments on this report. Feedback and enquiries about any aspects of this report may be directed to:

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Governor's Foreword

This is my first annual report as the Reserve Bank of Australia's eighth Governor. I am very honoured to have been appointed to this important position of public service. My appointment follows the retirement of Glenn Stevens AC after 10 years as Governor. During that time Glenn made an outstanding contribution to public policy in Australia, serving the public interest with great distinction. He also provided leadership within the Bank as we managed a period of significant change, undertaking major projects of national interest. I am fortunate to have these strong achievements to build on as I commence my term as Governor.

Over the course of 2016/17, there was a progressive improvement in the global economy. Nearly a decade after the onset of the financial crisis, a reasonably broad-based pick-up in global growth now looks to be under way. Unemployment rates are trending lower and are at, or below, multi-decade lows in some of the largest economies. Policy interest rates in the United States have been increased several times and a number of other central banks are considering when to remove some of the monetary stimulus that has been put in place over recent years. This is a marked change from the years since the financial crisis, when the issue had been how much additional monetary stimulus would be required. Financial markets, including in emerging market economies, have to date coped well with this change.

As has been the case for some years now, inflation is below target in most economies. Although there was some increase in inflation over the past year, this was largely on the back of higher oil prices. Wage growth remains low, even in countries with low unemployment rates. In some countries this largely reflects weak productivity growth, but this is not the whole story. A reduced sense of job security and an increased sense of competition look to be weighing on wage outcomes in many advanced economies, including here in Australia. How long this lasts will have a bearing on the future course of global monetary policy.

Over the year in review, Australia's national income benefited from a rise in commodity prices, in contrast to the decline in prices over recent years. Growth in output in Australia over 2016/17 was a little lower than earlier expected, but the drag from the large decline in mining investment is now coming to an end. The unemployment rate ended the year a little below where it started the year. Wage growth remains low, partly reflecting the same factors that are at work internationally. Inflation, too, remains low, but it increased over the year. The coming year is likely to see better growth in the Australian economy.

The Reserve Bank Board adjusted the cash rate target once in the year in review, lowering it to 1.5 per cent in August 2016. This followed inflation outcomes earlier that year that were noticeably lower than expected. Since then the Board has held the cash rate steady, with the stimulatory setting of monetary policy helping the economy adjust to the winding down of the mining investment boom.

Over the year, the Board has paid close attention to developments in household balance sheets and housing markets. It has sought to strike a reasonable balance in delivering an average rate of inflation over time of between 2 and 3 per cent in a way that promotes the public interest and does not add to medium-term financial stability risks. The importance of financial stability considerations in interest rate decisions was formally recognised in the revised *Statement on the Conduct of Monetary Policy* that was agreed between the Treasurer and me on my appointment as Governor in September 2016.

During the year the Reserve Bank worked closely with other financial regulators, including through the Council of Financial Regulators, to address the medium-term financial stability risks arising from household borrowing. The various measures have helped strengthen lending standards. There is a strong culture of cooperation between the various regulatory agencies in Australia and this was on display again during the year in review. This is a valuable aspect of Australia's regulatory arrangements and one that does not exist in all countries.

In 2016/17, the Reserve Bank recorded an accounting loss of $0.9 billion, reflecting valuation losses on holdings of foreign assets due to the exchange rate appreciation over the year. The underlying rate of return on the Bank's assets remained low, a result of the low level of interest rates in Australia and elsewhere. Over the year, underlying earnings were $1.0 billion and an additional $0.3 billion was earned in realised capital gains.

The Reserve Bank Board is committed to the Bank having a strong balance sheet so that it can effectively perform its operations under a wide range of scenarios. As the balance sheet has grown over recent times, there has been an increase in the share of the Bank's assets that have relatively low market risk. Given this change, the Board undertook a review of the capital framework during the year to ensure the amount of capital held against the various assets is determined by the risk of those assets. The new framework at present delivers a similar dollar target for capital as the previous arrangements, but is more sensitive to risk. With the current balance in the Reserve Bank Reserve Fund consistent with the Board's target capital level, the Bank did not seek a transfer to this fund in 2016/17. Accordingly, with the unrealised valuation loss being absorbed by previously accumulated unrealised gains, a dividend of $1.3 billion will be paid to the Australian Government.

Over recent years the Reserve Bank has been undertaking significant investments in important public interest projects, many of which have a high information technology component. The Bank has been building a core part of Australia's New Payments Platform, with this major effort completed on time. This payments infrastructure will allow Australians to make real-time, information-rich payments without having to exchange BSB and account numbers. We are also making a large investment in our banking systems, so that we can continue to provide high-quality and cost-effective banking services to the Australian Government and its agencies. One result of this work is that the Australian Government will be able to make and receive payments over Australia's New Payments Platform.

A major achievement of the Reserve Bank early in the year in review was the issuing of a new $5 banknote. The new banknote was developed over many years and has world-leading security features. I am pleased to be able to report that it has been well accepted by the public. The year also saw the completion of construction of a new vault and banknote distribution centre in Craigieburn, Victoria. This investment was made necessary by the continuing growth in the value of banknotes in circulation. While cash is being used less in day-to-day transactions, the value of banknotes on issue relative to GDP is at its highest in more than five decades, reflecting its ongoing use as a store of value.

There was a further increase in the Reserve Bank's staff numbers over 2016/17, reflecting the extra effort on the large payments and banking projects. Operating costs for ongoing activities, excluding depreciation and project work, rose by 4.6 per cent. As projects are completed, some reduction in staff numbers is expected in 2017/18. The Bank recently commissioned an external review of its operational efficiency. The review provided assurance that the support services were functioning well in helping pursue the Bank's objectives and also recommended some areas for improvement. We are now in the process of implementing those recommendations.

Australia is well served by having a central bank with highly competent staff who share a strong commitment to serving the public interest. The Reserve Bank's staff have high standards and go about their work with quiet professionalism. The Reserve Bank Board joins me in thanking the staff for their service.

Philip Lowe
Governor and Chair, Reserve Bank Board
16 August 2017

Part 1: About the Reserve Bank

Our Role

In its role as Australia's central bank, the Reserve Bank of Australia determines and implements monetary policy, fosters financial stability, undertakes a range of activities in financial markets, acts as a banker to the Australian Government, issues Australia's banknotes and has policy, supervisory and operational roles in the payments system.

The Reserve Bank of Australia is established by statute as Australia's central bank. Its enabling legislation is the *Reserve Bank Act 1959*. The Bank pursues national economic policy objectives. Its responsibility for monetary policy is set out in section 10(2) of the Reserve Bank Act, which states:

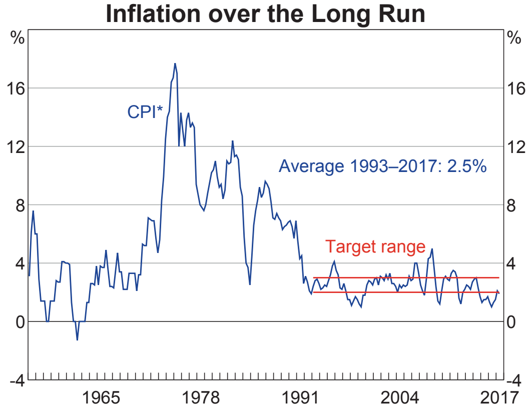
> It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank … are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:
>
> (a) the stability of the currency of Australia;
>
> (b) the maintenance of full employment in Australia; and
>
> (c) the economic prosperity and welfare of the people of Australia.

Policies in pursuit of these objectives have found practical expression in a flexible, medium-term inflation target, which has formed the basis of Australia's monetary policy framework since the early 1990s. The policy objective is for consumer price inflation to average between 2 and 3 per cent over time. Monetary policy aims to achieve this objective as a precondition for the promotion of sustainable economic growth and employment.

The seventh *Statement on the Conduct of Monetary Policy*, agreed by the Treasurer and the Governor on 19 September 2016, records the common understanding of the government and the Reserve Bank on key aspects of the monetary policy framework. This latest update of the statement confirmed the monetary policy framework in Australia, explicitly recognising that it is appropriate for the Reserve Bank Board to take account of financial stability considerations in determining the appropriate setting of monetary policy.

The Reserve Bank works with other regulatory agencies in Australia to foster overall financial stability, which is an important underpinning of a stable macroeconomic environment.

Inflation over the Long Run



* Excludes interest charges prior to September quarter 1998 and adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

The Governor chairs the Council of Financial Regulators (CFR), a non-statutory coordinating body for Australia's main financial regulatory agencies, whose role is to contribute to the efficiency and effectiveness of regulation and to promote the stability of the Australian financial system. Its members – the Reserve Bank, the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the Australian Treasury – share information, discuss regulatory issues and, if the need arises, coordinate responses to potential threats to financial stability. The CFR also advises the Australian Government on Australia's financial regulatory arrangements.

Australia's financial stability policy framework includes mandates for financial stability for both APRA and the Reserve Bank. APRA is responsible for prudential supervision of financial institutions and the Bank is responsible for promoting overall financial system stability. In the event of a financial system disturbance the Bank and relevant agencies would work to mitigate the risk of systemic consequences. The Bank's responsibility to promote financial stability does not, however, equate to a guarantee of solvency for financial institutions and the Bank does not see its balance sheet as being available to support insolvent institutions. Nevertheless, the Bank's central position in the financial system – and its position as the ultimate provider of liquidity to the system – gives it a key role in financial crisis management, in conjunction with the other members of the CFR.

The Reserve Bank conducts operations in domestic and international financial markets and undertakes analysis of markets and institutional developments in support of the Bank's policy objectives. These include ensuring there is sufficient liquidity in the domestic money market on a daily basis, in support of the Bank's monetary policy and financial system stability objectives. It operates in the foreign exchange market to meet the foreign exchange needs of its clients (the largest of which is the Australian Government) and to assist with liquidity management in domestic markets. The Bank holds and manages Australia's foreign currency reserves, and has the capacity to intervene in the foreign exchange market to address any apparent dysfunction in that market or significant misalignment in the value of the currency, consistent with the objectives of monetary policy.

The Reserve Bank has responsibility for ensuring the stability, efficiency and competitiveness of the payments system through the Payments System Board, which was established in 1998. The Bank's powers in relation to the payments system are set out in a number of statutes, including the *Payment Systems (Regulation) Act 1998* and the *Payment Systems and Netting Act 1998*. Under the *Corporations Act 2001*, the Bank, through the Payments System Board, has responsibility for determining financial stability standards for licensed clearing and settlement facilities and assessing facilities' compliance with those standards.

The Reserve Bank also has an operational role in the payments system, as owner and manager of Australia's high-value payments system – the Reserve Bank Information and Transfer System (RITS). A separate area of the Bank assesses RITS against international standards for such infrastructure on an annual basis.

The Reserve Bank provides specialised banking services to government and foreign official institutions, including payments and collections as well as general account maintenance and reporting.

The Reserve Bank works with its wholly owned subsidiary, Note Printing Australia Limited, to design and produce Australia's banknotes. The Bank issues banknotes with the objective of ensuring public confidence in them as an effective payment mechanism and a secure store of value.

Governance

The Reserve Bank has two boards: the Reserve Bank Board, which has responsibility for monetary and banking policy and the Bank's policy on other matters excluding payments system policy; and the Payments System Board, which has responsibility for payments system policy. Subject to policy set by the boards, the Bank is managed by the Governor.

The Reserve Bank's governance structure is set out in the *Reserve Bank Act 1959*. The Governor is the accountable authority of the Bank for the purposes of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). The Governor is assisted in fulfilling his responsibilities to manage the Bank by two key management committees, the Executive Committee and the Risk Management Committee.

Reserve Bank Board

The Reserve Bank Board has responsibility for monetary and banking policy and the Reserve Bank's policy on all other matters except payments system policy. The Board comprises the Governor (Chair), Deputy Governor (Deputy Chair), Secretary to the Treasury and six non-executive members appointed by the Treasurer, a total of nine. Members of the Board during 2016/17 are shown below and details of their qualifications and experience are provided on pages 16–25. In mid September 2016, Philip Lowe succeeded Glenn Stevens as Governor and Guy Debelle took office as Deputy Governor. The Board's tribute to Mr Stevens on the occasion of his retirement is shown on page 24.

The Reserve Bank Board meets 11 times a year, on the first Tuesday of each month except in January. Five members form a quorum for a meeting of the Board. In accordance with the Reserve Bank Act, the Board makes decisions by a majority of the votes of the members present and voting, with the chair having a casting vote, if necessary, in addition to a deliberative vote.

Reserve Bank Board meetings are usually held at the Reserve Bank's Head Office in Sydney. Meetings are held in two other Australian cities each year. The Board's most recent interstate meeting was in Melbourne in April 2017.

The Reserve Bank Board has an Audit Committee and a Remuneration Committee, whose activities are described below.

Payments System Board

The responsibilities of the Payments System Board are set out in the Reserve Bank Act. In particular, the Act requires the Board to ensure, within the limits of its powers, that the Reserve Bank's payments system policy is directed to the greatest advantage of the people of Australia and that its related powers are exercised in

Board Meetings – 2016/17
Attendance by members

	No. of meetings attended	No. of meetings eligible to attend
Glenn Stevens[(a)]	3	3
Philip Lowe (Governor)[(b)]	11	11
Guy Debelle (Deputy Governor)[(c)]	8	8
John Fraser (Secretary to the Treasury)	10[(d)]	11
John Akehurst	11	11
John Edwards[(e)]	1	1
Kathryn Fagg	11	11
Ian Harper[(f)]	10	10
Allan Moss	11	11
Heather Ridout[(g)]	6	7
Carol Schwartz[(h)]	4	4
Catherine Tanna	11	11

(a) Glenn Stevens' term as Governor ended on 17 September 2016
(b) Philip Lowe was Deputy Governor until 17 September 2016 and Governor from 18 September 2016
(c) Guy Debelle's term on the Board commenced on 18 September 2016 following his appointment as Deputy Governor
(d) Nigel Ray (Deputy Secretary, Macroeconomic Group, Australian Treasury) attended the September 2016 meeting in place of John Fraser, in terms of section 22 of the Reserve Bank Act
(e) John Edwards' term on the Board ended on 30 July 2016
(f) Ian Harper's term on the Board commenced on 31 July 2016
(g) Heather Ridout's term on the Board ended on 13 February 2017
(h) Carol Schwartz's term on the Board commenced on 14 February 2017
Source: RBA

such a way that, in the Board's opinion, will best contribute to:

(i) controlling risk in the financial system; and

(ii) promoting the efficiency of the payments system; and

(iii) promoting competition in the market for payment services, consistent with the overall stability of the financial system.

The Payments System Board also has responsibility to ensure that the powers and functions of the Bank under Part 7.3 of the *Corporations Act 2001* (dealing with licensing of clearing and settlement facilities) are exercised in a way that will best contribute to the overall stability of the financial system.

The Payments System Board issues a separate annual report.

Conduct of Reserve Bank Board Members

On appointment to the Reserve Bank Board, each member is required under the Reserve Bank Act to sign a declaration to maintain confidentiality in relation to the affairs of the Board and the Reserve Bank.

Members must comply with their statutory obligations as officials of the Reserve Bank, including those set out in the PGPA Act. Members' obligations under the PGPA Act include, but are not limited to, obligations to exercise their powers and discharge their duties with care and diligence, honestly, in good faith and for a proper purpose. Members must not use their position, or any information obtained by virtue of their position, to benefit themselves or any other person, or to cause detriment to the Reserve Bank or any other person.

In order for members to discuss and decide monetary and financial stability policies, notwithstanding any material personal interest in the outcome, the Reserve Bank Act requires them to furnish a confidential disclosure of material personal interests to the Treasurer annually and, during the year, to notify any substantial change since their most recent annual disclosure. Members must declare to the other members of the Reserve Bank Board any material personal interest they have in a matter relating to the affairs of the Board other than monetary policy and financial stability. Members may give standing notice to other members outlining the nature and extent of a material personal interest in such matters.

A Code of Conduct for Reserve Bank Board members supplements these statutory requirements and imposes obligations on members that are designed to ensure that members observe the highest possible standards of ethical conduct. The Code of Conduct, which is available on the Reserve Bank's website, addresses a range of matters including conflicts of interest and restrictions on undertaking, or being involved in, financial transactions of certain types at certain times.

Audit Committee

The Audit Committee is constituted as a subcommittee of the Reserve Bank Board. Its primary objective is to assist the Governor and the Board in fulfilling certain obligations in terms of the Reserve Bank Act and the PGPA Act. In particular, the Audit Committee assists the Governor and the Board in relation to:

- preparing the annual report, including a report of operations, a performance statement and the financial statements
- establishing and maintaining appropriate systems of internal control
- establishing and maintaining appropriate systems of risk oversight and management.

John Akehurst, a member of the Reserve Bank Board, chairs the Audit Committee. Other members of the committee are Kathryn Fagg, a member of the Reserve Bank Board, and Sandra Birkensleigh and Michael Coleman, both of whom are company directors and former senior audit partners of major accounting firms who have extensive experience in the finance sector.

Consistent with contemporary governance standards, no Reserve Bank executive is a member of the Audit Committee. Representatives of the Bank's internal and external auditors participate in meetings as appropriate at the invitation of the chair. The Deputy Governor attends meetings of the committee on a regular basis as the chief representative of the Bank's management. Other senior Bank executives attend meetings of the committee by invitation on a regular basis or as required.

During 2016/17, the Audit Committee met on four occasions. At its July 2017 meeting, the committee considered the draft consolidated financial statements for the Reserve Bank for the year ended 30 June 2017 and agreed that the statements be presented to the Governor and the Reserve Bank Board with its endorsement. The committee meets at least annually with the external auditors without management present;

Audit Committee Meetings – 2016/17
Attendance by members

	No. of meetings attended	No. of meetings eligible to attend
John Akehurst[(a)]	4	4
Sandra Birkensleigh	4	4
Michael Coleman	3	4
Kathryn Fagg[(a)]	4	4

(a) Member of the Reserve Bank Board
Source: RBA

in respect of 2016/17, this occurred immediately following the July 2017 meeting.

Remuneration Committee

The Remuneration Committee of the Reserve Bank Board was established in terms of section 24A of the Reserve Bank Act to recommend to the Board 'terms and conditions relating to the remuneration and allowances' for the Governor and Deputy Governor. Membership of the committee is drawn from the non-executive members of the Board and comprises Catherine Tanna (Chair), Ian Harper and Allan Moss. During 2016/17, the committee met on three occasions.

The offices of Governor and Deputy Governor are Principal Executive Offices in terms of the *Remuneration Tribunal Act 1973*, which provides for the Remuneration Tribunal to determine the applicable remuneration reference rate for these offices. The Remuneration Committee reviews the terms and conditions (including remuneration) applying to the Governor and Deputy Governor annually and recommends adjustments to the Reserve Bank Board for approval, providing that such terms and conditions are consistent with the framework for Principal Executive Offices determined by the Remuneration Tribunal. The committee is also kept informed of the general remuneration arrangements for Reserve Bank staff. The Governor attends meetings of the committee at the invitation of the chair to discuss remuneration matters in the Bank, but not those relating to his own remuneration. The committee communicates with the Remuneration Tribunal as required.

In accordance with section 21A of the Reserve Bank Act, neither the Governor nor the Deputy Governor takes part in decisions of the Reserve Bank Board relating to the determination or application of any terms or conditions on which either of them holds office.

Remuneration Committee Meetings – 2016/17
Attendance by members

	No. of meetings attended	No. of meetings eligible to attend
Catherine Tanna	3	3
Ian Harper[(a)]	3	3
Allan Moss	3	3

(a) Ian Harper's term commenced on 31 July 2016
Source: RBA

Remuneration and Allowances

Remuneration and travel allowances for the non-executive members of the Reserve Bank Board are set by the Remuneration Tribunal. Remuneration of Board members for their membership of the Audit Committee is determined by the Remuneration Tribunal. The longstanding practice of the Reserve Bank has been to provide the same level of remuneration to members of the Audit Committee who are not also members of the Reserve Bank Board. Membership of the Remuneration Committee is not remunerated.

Induction of Board Members

The induction program assists newly appointed Reserve Bank Board members to understand their role and responsibilities, and provides them with an overview of the Reserve Bank's policy framework and operations. Separate briefing sessions are tailored to meet particular needs or interests.

Policy Risk Management Framework and Board Review

Towards the end of 2016, the Reserve Bank Board conducted its annual review of the key risks inherent in the formulation of monetary policy and the monetary policy risk register and control framework. The Board endorsed modest refinements to the risk register and concluded that the control framework had been operating effectively.

At the same time, the Reserve Bank Board conducted its annual review of its own operation and processes. It concluded that Board processes were functioning effectively. Members agreed that the addition of special topics for discussion at some meetings in 2015/16 had been valuable. This expansion of meeting agendas continued during 2016/17 and allowed the Board to spend more time on medium-term issues relevant to monetary policy at most Board meetings during the year. The performance of the Board's Audit and Remuneration committees is assessed as part of the annual survey of the effectiveness of the Board itself. The most recent review concluded that the committees and their processes were functioning effectively.

Executive Committee

The Executive Committee is the key decision-making committee of the Reserve Bank for matters of a management and/or administrative nature. It is a management committee, whose role is to assist and support the Governor in fulfilling his responsibilities to manage the Bank (under the Reserve Bank Act and as the accountable authority under the PGPA Act). The committee, which is chaired by the Governor and comprises the Bank's most senior executives, generally meets weekly. The heads of the Audit, Information and Risk and Compliance departments and the General Counsel attend meetings of the Executive Committee in an advisory capacity.

Risk Management Committee

The Risk Management Committee has responsibility for ensuring that operational and financial risks are identified, assessed and properly managed across the Reserve Bank in accordance with its Risk Management Policy. It is a management committee chaired by the Deputy Governor and comprises senior executives drawn mainly from the operational areas of the Bank. During 2016/17, the Risk Management Committee met on six occasions and kept the Executive Committee and Reserve Bank Board Audit Committee informed of its activities.

Risks associated with the formulation of monetary and payments policies are the direct responsibility of the Reserve Bank Board and the Payments System Board, respectively. The boards review management of these risks periodically as part of their decision-making processes. Details of the Reserve Bank's risk management framework are provided in the chapter on 'Risk Management'.

Indemnities for Members of Boards and Staff

Members of the Reserve Bank Board and the Payments System Board are indemnified against liabilities incurred by reason of their appointment to the relevant board or by virtue of holding and discharging such office. Indemnities for those members appointed prior to 1 July 2014 were in accordance with section 27M of the *Commonwealth Authorities and Companies Act 1997* (CAC Act), which specified when indemnity for liability and legal costs was not allowed. Indemnities for members appointed after 1 July 2014, when the CAC Act was repealed, have reflected the substance of the previous CAC Act restrictions. The terms of indemnification for new members of both boards were reviewed by the Reserve Bank Board in early 2017 and a revised form of indemnity, which continues to reflect the substance of the previous CAC Act restrictions, was approved in March 2017.

The Reserve Bank has also provided an indemnity in accordance with section 27M of the CAC Act to senior staff of the Bank in relation to liabilities they may incur in the conduct of their duties at the Bank. In March 2017 the Bank limited the application of that indemnity to claims or liability relating to events prior to 1 April 2017 and adopted a policy on assistance to staff for legal proceedings to replace that indemnity. The new policy applies to all staff, not only senior staff, and is closely based on the rules that apply to the provision of assistance to staff for legal proceedings in non-corporate Commonwealth entities set out in Appendix E to the *Legal Services Directions 2017*.

Certain other indemnities given prior to 1 July 2014 in accordance with section 27M of the CAC Act continue. These indemnities were provided by the Reserve Bank to current and former senior staff and Reserve Bank Board members who, at the request of the Bank, are serving on the board of Note Printing Australia Limited or formerly served on that board or the board of CCL Secure Pty Limited (formerly Innovia Security Pty Ltd and, prior to that, Securency International Pty Ltd).

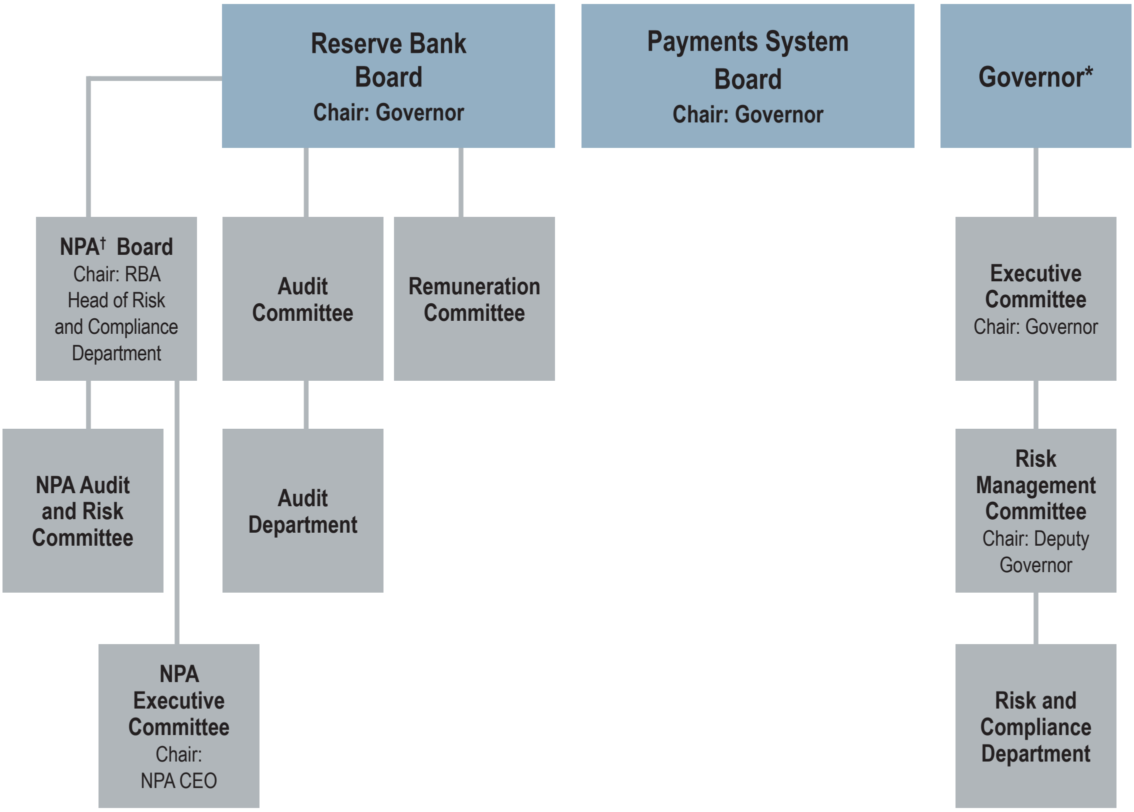
As the Reserve Bank does not take out directors' and officers' insurance in relation to members of its boards or other officers, no premiums were paid for any such insurance in 2016/17.

Other Policy Matters

As part of the governance arrangements to assist the Reserve Bank Board discharge its obligations in relation to the Reserve Bank's policies other than monetary policy, the Governor reports annually to the Board on the process of review and implementation of the key Reserve Bank policies that are determined and managed by the Governor. This report includes information on compliance arrangements. An annual report covering matters relating to work health and safety in the Bank is also presented to the Board. The reports for 2016/17 were provided to the Board at its August 2017 meeting.

Reserve Bank of Australia Governance Structure

16 August 2017



† Note Printing Australia Limited

* Under section 12 of the *Reserve Bank Act 1959*, the Governor is responsible for managing the Bank and under section 7A of the Reserve Bank Act, the Governor is the accountable authority of the Bank for the purposes of the *Public Governance, Performance and Accountability Act 2013*.

Reserve Bank Board

The Reserve Bank Board comprises nine members: the Governor (Chair), Deputy Governor (Deputy Chair), Secretary to the Treasury (ex officio member) and six other non-executive members appointed by the Treasurer. Further to the legislative requirements, and in recognition of their responsibility to uphold the integrity of the Board and the Reserve Bank, members have adopted a Code of Conduct.

There were three retirements from the Reserve Bank Board in 2016/17, John Edwards in late July 2016, as recorded in the 2016 annual report, former Governor Glenn Stevens in mid September 2016 and Heather Ridout in mid February 2017. Tributes by the Board to Mr Stevens and Mrs Ridout recorded at their final meetings are shown on pages 23 and 24 respectively.

August 2017

Philip Lowe

BCom (Hons) (UNSW), PhD (MIT)

Governor and Chair

Governor since 18 September 2016

Present term ends 17 September 2023

Philip Lowe was Deputy Governor from February 2012 until his appointment as Governor took effect in September 2016. Prior to that, he held various senior positions at the Reserve Bank, including Assistant Governor (Economic) and Assistant Governor (Financial System), where he was responsible for overseeing economic and policy advice to the Governor and Reserve Bank Board. He spent two years at the Bank for International Settlements working on financial stability issues. Dr Lowe has authored numerous papers, including on the linkages between monetary policy and financial stability. He is a signatory to The Banking and Finance Oath.

Other roles

Chair – Payments System Board

Chair – Council of Financial Regulators

Chair – Financial Markets Foundation for Children

Member – Financial Stability Board

Co-Chair – Financial Stability Board Regional Consultative Group for Asia

Member – Bank for International Settlements Group of Governors and Heads of Supervision

Member – Trans-Tasman Council on Banking Supervision

Director – The Anika Foundation

Guy Debelle

BEc (Hons) (Adelaide), PhD (MIT)

Deputy Governor and Deputy Chair

Deputy Governor since 18 September 2016

Present term ends 17 September 2021

Prior to his appointment as Deputy Governor, Guy Debelle was Assistant Governor (Financial Markets) from March 2007. In that role he had oversight of the Bank's operations in the domestic and global financial markets. He has also worked at the Australian Treasury, International Monetary Fund and Bank for International Settlements, and he was a Visiting Professor at the Massachusetts Institute of Technology in 2003. Until May 2017, Dr Debelle was Chair of the Bank for International Settlements Foreign Exchange Working Group, which developed the Global Code of Conduct for the Foreign Exchange Market. He is a signatory to The Banking and Finance Oath.

Other roles

Chair – Australian Foreign Exchange Committee

Chair – Reserve Bank Risk Management Committee

John Akehurst

MA (Oxon)

Non-executive member

Member since 31 August 2007

Present term ends 30 August 2017

John Akehurst has had extensive experience in the oil and gas industry. He held a number of engineering and management positions with Royal Dutch Shell (1976–96) and as CEO of Woodside Petroleum Ltd (1996–2003). Mr Akehurst is a former chairman of Alinta Ltd and Coogee Resources Ltd and a former director of CSL Ltd, Oil Search Ltd and the University of Western Australia Business School. Mr Akehurst is a Fellow of the Institution of Mechanical Engineers.

Other roles

Chair – National Centre for Asbestos Related Diseases

Chair – Transform Exploration Pty Ltd

Director – Origin Energy Limited

Reserve Bank Board committee membership

Chair – Audit Committee

Kathryn Fagg

BE (Hons) (Queensland), MCom (Hons) (UNSW)

Non-executive member

Member since 7 May 2013

Present term ends 6 May 2018

Kathryn Fagg has broad experience across a range of industries, including logistics, manufacturing, resources, banking and professional services, having worked in senior executive roles at Linfox, BlueScope Steel and the ANZ Banking Group. Earlier, she worked at McKinsey & Company after commencing her career as a petroleum engineer with Esso Australia. She has led businesses in Australia, New Zealand and Asia. Ms Fagg is President of Chief Executive Women and a Fellow of the Australian Academy of Technology and Engineering. She was awarded a Doctor of Business, *honoris causa* by the University of New South Wales Business School in November 2015, and a Doctor of Chemical Engineering, *honoris causa* by the University of Queensland in December 2016.

Other roles

Chair – Breast Cancer Network Australia

Chair – Melbourne Recital Centre

Director – Boral Limited

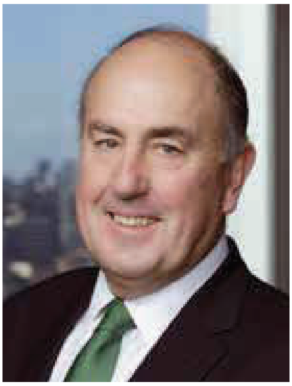
Director – Djerriwarrh Investments Limited

Director – Incitec Pivot Limited

Director – Note Printing Australia Limited

Reserve Bank Board committee membership

Member – Audit Committee



John Fraser

BEc (Hons) (Monash)

Ex officio member

Secretary to the Treasury

Member since 15 January 2015

John Fraser was appointed Secretary to the Treasury in 2015. He was Chairman and CEO of UBS Global Asset Management from late 2001 to 2013, based in London. During this time, he was also a member of the UBS Group Executive Board and Chairman of UBS Saudi Arabia. In 2014, Mr Fraser remained as Chairman of UBS Global Asset Management, Chairman of UBS Saudi Arabia and Chairman of UBS Grocon Real Estate. Prior to joining UBS and its predecessor organisations in 1993, he served for over 20 years with the Australian Treasury, including as Deputy Secretary (Economic) from 1990 and postings at the International Monetary Fund and as Minister (Economic) at the Australian Embassy in Washington, DC. Mr Fraser was a member of the ASX Board from 1998 to 2002 and Chairman of Victorian Funds Management Corporation from 2009 to early 2015. In 2013, Mr Fraser was awarded an honorary Doctor of Laws by Monash University and in 2015 was appointed an Honorary Professor at Durham University (UK).

Other roles

Chair – Global Infrastructure Hub

Ex officio member – Board of Taxation

Member – Council of Financial Regulators

Member – Sir Roland Wilson Foundation

Member – Trans-Tasman Council on Banking Supervision

Ian Harper

BEc (Hons) (Queensland), MEc, PhD (ANU)

Non-executive member

Member since 31 July 2016

Present term ends 30 July 2021

Ian Harper has extensive experience in public policy development, academia and economic consulting. Professor Harper chaired the Competition Policy Review (Harper Review), served as a member of the Financial System Inquiry (the Wallis Inquiry), and was the inaugural Chairman of the Australian Fair Pay Commission. He spent two decades as a Professor at the University of Melbourne – first as the NAB Professor of Monetary and Financial Economics (1988–92), then as the Ian Potter Professor of International Finance (1992–2002) and the Sidney Myer Professor of Commerce and Business Administration (2002–08) at Melbourne Business School. Professor Harper spent eight years as an economic consultant – first as a director of Access Economics Pty Ltd (2008–11) and then as a partner of Deloitte Touche Tohmatsu (2011–16).

Other roles

Senior Advisor – Deloitte Access Economics Pty Ltd

Chair – Stipends Committee, Anglican Diocese of Melbourne

Director – Harper Associates Australia

Director – Ridley College Limited

Member – Public Policy Committee, Grattan Institute

Reserve Bank Board committee membership

Member – Remuneration Committee

Allan Moss AO

BA, LLB (Hons) (Sydney), MBA (Harvard)

Non-executive member

Member since 2 December 2015

Present term ends 1 December 2020

Allan Moss has extensive experience in financial markets. He held various positions at Macquarie Bank before becoming Managing Director and Chief Executive Officer of Macquarie Bank Limited and subsequently Macquarie Group Limited from 1993 to 2008. Prior to this, Mr Moss was a director of Hill Samuel Australia and led the team responsible for preparing the submission to the Australian Government to form Macquarie Bank in 1983.

Other roles

Principal – Allan Moss Investments Pty Ltd

Adviser – Anchorage Capital Partners

Advisory Board member – Eight Investment Partners Pty Ltd

Advisory Board member – Evans and Partners

Reserve Bank Board committee membership

Member – Remuneration Committee

Carol Schwartz AM

BA, LLB, MBA (Monash)

Non-executive member

Member since 14 February 2017

Present term ends 13 February 2022

Carol Schwartz has extensive experience in business, property, the arts and community organisations. Past high-level leadership roles, including a portfolio of diverse board appointments, have spanned the business, government, arts, health and community sectors. In 2007, Mrs Schwartz was awarded an Order of Australia for her service to business and commerce and her support for health promotion organisations, preservation of historic buildings and the arts. She received the Centenary Medal in 2001 in recognition of her outstanding service as a leading business executive and committee participant. Mrs Schwartz is a Fellow of the Australian Institute of Company Directors.

Other roles

Founding Chair – Women's Leadership Institute Australia

Chair – Creative Partnerships Australia

Chair – Our Community

Director – Qualitas Property Partners

Director – Stockland

Director – Trawalla Group

Catherine Tanna

LLB (Queensland)

Non-executive member

Member since 30 March 2011

Present term ends 29 March 2021

Catherine Tanna has extensive experience in the resources sector with BG Group, Royal Dutch Shell and BHP Billiton. She held senior executive roles with responsibility for liquefied natural gas, gas transmission and power-generation businesses across Africa, North Asia, Russia, North America, Latin America and Australia. From April 2012 to the end of June 2014, Ms Tanna was Chairman of BG Australia. She is a member of Chief Executive Women.

Other roles

Managing Director – EnergyAustralia Holdings Ltd

Board Member – Business Council of Australia

Reserve Bank Board committee membership

Chair – Remuneration Committee

Retirements from the Board

Glenn Stevens AC retired from the Board on 17 September 2016

Heather Ridout AO retired from the Board on 13 February 2017

Glenn Stevens AC

BEc (Hons) (Sydney), MA (Western)

Governor and Chair

Governor from 18 September 2006 to 17 September 2016

Prior to his appointment as Governor, Glenn Stevens held various senior positions at the Reserve Bank, including Head of Economic Analysis and International departments and Assistant Governor (Economic), where he was responsible for overseeing economic and policy advice to the then Governor and Reserve Bank Board. He was Deputy Governor from 2001 to 2006. In June 2014, Mr Stevens was awarded a Doctor of Laws, *honoris causa* (LLD) by Western University in Ontario, Canada. In the 2016 Queen's Birthday Honours, Mr Stevens was appointed a Companion in the Order of Australia for eminent service to the financial and central bank sectors and to the community.

Other roles during his term as Reserve Bank Governor

Chair – Payments System Board

Chair – Council of Financial Regulators

Chair – Financial Stability Board Standing Committee for Assessment of Vulnerabilities

Chair – Financial Markets Foundation for Children

Member – Financial Stability Board

Director – The Anika Foundation

Member – Bank for International Settlements Group of Governors and Heads of Supervision

Member – Trans-Tasman Council on Banking Supervision

Resolution passed by the Reserve Bank Board – 6 September 2016

On the occasion of his final meeting after 10 years as Governor and Chair of the Board, members warmly congratulated Glenn Stevens for his outstanding service to the Bank and to the nation. Prior to being appointed Governor in 2006, Mr Stevens had served as Deputy Governor for almost five years and had presented to the Board regularly as Assistant Governor (Economic) between 1997 and 2001. The Governor-designate, Philip Lowe, paid tribute to Mr Stevens' exceptional contribution to the deliberations of the Board over this long period. On behalf of all members, he expressed appreciation and admiration for Mr Stevens' professionalism and integrity, his thoughtful and consultative approach to policymaking and for the exceptional judgements he made during a challenging period for the global and Australian economy. Members recorded their appreciation of Mr Stevens' dedication to public policy in a career spanning more than three decades and wished him well for the future.

Heather Ridout AO

BEc (Hons) (Sydney)

Non-executive member

Member from 14 February 2012 to 13 February 2017

Heather Ridout has a strong understanding of public policy and the manufacturing sector, having previously been Chief Executive of the Australian Industry Group. Her previous appointments include key national policy-setting and consultative groups, including as a member of the Henry Tax Review Panel, board member of Infrastructure Australia, member of the Prime Minister's Taskforce on Manufacturing and member of the Australian Workforce and Productivity Agency. Mrs Ridout is a member of Chief Executive Women.

Other roles (as at 13 February 2017)

Chair – AustralianSuper Pty Ltd

Director – Australian Chamber Orchestra

Director – Australian Securities Exchange Limited

Director – Image Networks Holdings Pty Ltd

Director – Note Printing Australia Limited

Director – Sims Metal Management Limited

Resolution passed by the Reserve Bank Board – 7 February 2017

On the occasion of her final meeting, after serving for five years on the Board, members paid tribute to Heather Ridout's professionalism and dedication. On behalf of all members, the Governor expressed appreciation for Mrs Ridout's contribution to the deliberations of the Board, both on monetary policy and other matters, drawing on her knowledge of manufacturing businesses and her extensive experience in other public policy roles. The Governor thanked Mrs Ridout for her significant contribution as a Board member of Note Printing Australia Limited (NPA), where she had supported the company in achieving high standards. He also applauded her constructive and collegiate style and her strong support for the work of NPA. Members thanked Mrs Ridout for her service to the Bank and the nation and wished her the very best for the future.

Accountability and Communication

The Reserve Bank is an independent central bank, accountable to the Parliament of Australia. The Bank engages with the Australian Government at a range of levels and seeks to enhance the community's understanding of its responsibilities, policies and actions through a broad communication program.

Relationship with Government

The Reserve Bank is a body corporate distinct from the Commonwealth of Australia. This body corporate, established under the *Commonwealth Bank Act 1911* and continued in existence under the *Commonwealth Bank Act 1945*, was preserved and continued in existence with the name Reserve Bank of Australia under the *Reserve Bank Act 1959*. The Reserve Bank has two boards: the Reserve Bank Board and the Payments System Board. The Governor, Deputy Governor and other members of the Reserve Bank Board are appointed by the Treasurer. Six of the eight members of the Payments System Board, including the Governor, are appointed by the Treasurer, with one member each appointed by the Reserve Bank and the Australian Prudential Regulation Authority.

The Reserve Bank's two boards are afforded operational independence under the Reserve Bank Act to determine and implement the policies of the Bank, as will best contribute to the objectives set out in the Act. In terms of monetary policy, The *Statement on the Conduct of Monetary Policy*, as updated from time to time, has recorded the common understanding of the Governor, as Chair of the Reserve Bank Board, and the government on key aspects of Australia's monetary and central banking policy framework since 1996, as outlined in the chapter on 'Our Role'. The Payments System Board issues its own annual report, which outlines its role and activities.

Accountability and Communication

The Reserve Bank seeks to ensure a high degree of transparency about its activities, goals, decision-making processes and the basis of its policy decisions. Transparency facilitates the Bank's accountability, to accompany its operational independence. Importantly, it also increases the effectiveness of policy decisions by promoting a better understanding of those decisions in the community. There are a number of steps the Bank takes to achieve this transparency, as discussed below. These steps are an important element of the arrangements agreed between the Governor and the Treasurer as set out in the *Statement on the Conduct of Monetary Policy*.

The Reserve Bank Board has an obligation to inform the government of its monetary and banking policy 'from time to time'. This obligation is discharged mainly by regular contact between the Governor and other senior executives and the Treasurer, who is the Bank's responsible Minister (during 2016/17, The Hon Scott Morrison MP),

(Top) Governor Philip Lowe addresses the CEDA Annual Dinner, November 2016; (above) Deputy Governor Guy Debelle speaking about the FX Global Code of Conduct at a Thomson Reuters industry event, June 2017

Assistant Governor (Financial System) Michele Bullock speaking at the Teacher Immersion Event held in the Reserve Bank Head Office, June 2017

usually by way of a monthly discussion following Board meetings. The Reserve Bank Act sets out a clear process for managing differences of opinion between the Reserve Bank Board and the government on policy matters.

The Reserve Bank is a corporate Commonwealth entity under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), of which the Governor is the 'accountable authority'. Under section 46 of the PGPA Act, the Governor is responsible for the preparation of this annual report and for providing it to the Treasurer for presentation to the Parliament, following approval by the Reserve Bank Board of the Bank's annual financial statements. That approval was given by the Board at its meeting on 1 August 2017.

The House of Representatives Economics Committee has, in its Standing Orders, an obligation to review the annual report of the Reserve Bank and the annual report of the Payments System Board. The committee holds twice-yearly public hearings, at which the Bank presents its views on the economy and financial markets and other matters pertaining to the Bank's operations, and responds to questions from committee members. In 2016/17, the Governor and senior Bank officers attended hearings of this committee for this purpose in Sydney in September 2016 and February 2017. The committee issued its report on the September 2016 hearing – *Review of the Reserve Bank of Australia Annual Report 2015* (Second Report) – on 7 November 2016. The committee's

Novatti Chief Executive Officer Peter Cook, Reserve Bank Head of Payments Policy Department Tony Richards, Australian Payments Network Chief Executive Officer Leila Fourie, eftpos Chief Product Officer Marie Kellett and RFi Group Head of Payments – Lead Consultant Alex Boorman during the panel discussion at the Australian Retail Banking Summit, May 2017

report on the February 2017 hearing – *Review of the Reserve Bank of Australia Annual Report 2016* (First Report) – was issued on 30 March 2017.

No report on the Reserve Bank was issued in 2016/17 by the Commonwealth Ombudsman, the Office of the Australian Information Commissioner or the Auditor-General, apart from that dealing with the annual audit of the Bank's annual financial statements.

The Bank communicates and engages regularly with the public in a range of other ways, as discussed below.

Regional and industry liaison

In addition to its Head Office located in Sydney, the Reserve Bank has offices in Adelaide, Brisbane, Melbourne and Perth, whose key purpose is to conduct the Bank's regional and industry liaison program. These offices also play an important role in the Bank's communication with members of the public, business, community organisations, government and academia in their respective states.

Reserve Bank staff meet regularly with businesses, associations and agencies in every state and across all industries in the Australian economy. In 2016/17, staff involved in the

The Bank communicates and engages regularly with the public regional and industry liaison program conducted over 900 such meetings. The discussions with individual firms occur around every six to twelve months, although staff tend to speak more frequently with firms in industries that are bellwether indicators of economic activity and consumer price pressures.

The information collected under the liaison program complements that available from official sources and helps the Reserve Bank to monitor cyclical and structural developments, as well as the effect of unusual events on the Australian economy. The broad messages gathered through liaison are incorporated into the Bank's policy discussions and public communication. While much of this information is used internally in helping shape the Bank's assessment of the Australian economy, a number of the topical articles that feature regularly in the Reserve Bank *Bulletin* draw on the broad themes and messages coming from the liaison program.

Staff from the State Offices also play a role in the Reserve Bank's efforts to keep the public informed of its evolving views on the economy and the functions of the Bank more generally.

In 2016/17, staff involved in the regional and industry liaison program conducted over 900 meetings

They hold discussions with a broad cross-section of the community, regularly giving presentations on economic developments to business groups, community organisations and educational institutions in state capitals and regional centres. In 2016/17, staff from the Bank's State Offices gave nearly 50 of these presentations. These involved a mix of smaller, round-table sessions, as well as presentations to high school and university economics students as part of the Bank's public education program (see the chapter on 'Community Engagement').

Staff from the State Offices also regularly visit Tasmania and the Northern Territory to gather information on economic conditions in those parts of Australia. In 2016/17, staff also visited regional centres, including Bunbury and Kalgoorlie in Western Australia, Ballarat and Geelong in Victoria, the Barossa Valley in South Australia and the Gold Coast in Queensland.

The Reserve Bank also continues to convene its Small Business Finance Advisory Panel, which was established in 1993. The panel meets annually to discuss issues relating to the provision of finance and the broader economic environment for small businesses. Membership of the panel is drawn from a range of industries across the country. The panel provides a valuable source of information on financial and economic conditions faced by small businesses. The Bank's liaison program also involves Bank staff meeting with a number of small businesses and small business groups.

Consultation and other engagement

Feedback from public consultation is an important input to decision-making by the Reserve Bank. In 2016/17, the Bank conducted a formal consultation on issues relating to dual-network cards and mobile wallet technology. On the basis of this consultation and resulting outcomes, the Payments System Board decided that there was no need for regulation

In 2016/17, staff from the Bank's State Offices gave nearly 50 presentations

in this area. The Bank continues to monitor developments in mobile payments, as discussed further in the *Payments System Board Annual Report 2017*.

A consultation was also conducted in early 2017 by the Council of Financial Regulators (CFR) – comprised of the Reserve Bank, the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission and the Australian Treasury – in relation to policy guidance that would be required to ensure safe and effective competition in cash equity settlement in Australia. The council agencies subsequently considered the responses received, with a view to advising the government in the second half of 2017 on the need for additional policy guidance.

The Reserve Bank also maintains ongoing engagement with a wide variety of groups to inform its policy and operational activities. Senior Bank staff meet regularly with representatives of various domestic and international official agencies, business groups and financial market participants to discuss economic and financial developments.

During the year in review, senior staff members from the Payments Policy Department participated in a number of industry conferences where the Bank's work in this area was discussed. Staff from Payments Settlements Department continued to conduct regular liaison meetings with Reserve Bank Information and Transfer System (RITS) members and to participate in various industry forums, including the Australian Payments Network's High Value Clearing System Management Committee. In 2016/17, Bank staff also actively participated in the industry's New Payments Platform (NPP) project committees and were represented on the NPP Australia Limited Board. Participation in these groups and a number of other banking and payments industry forums ensures Bank staff are abreast of developments in these areas and can contribute to innovations in the banking and payments industry. Bank staff are closely following developments in new technologies, including distributed ledger technology (DLT), digital currencies and payments-related financial technology (or fintech) more broadly.

The Bank sponsors, and its International Department provides the secretariat to, the Australian Foreign Exchange Committee. Among other things, in 2016/17 the Committee coordinated the input of local market participants into the development of the global code of conduct for the wholesale foreign exchange market. During the year in review, staff from the Note Issue Department also continued to engage extensively in relation to the new banknote series, as discussed in the chapter on 'Banknotes'.

Research

The Reserve Bank disseminates the results of longer-term research conducted by staff in the form of Research Discussion Papers (RDPs). The purpose of the RDP series is to encourage discussion and comment on policy-relevant issues. The views expressed in RDPs are those of the authors and do not necessarily represent those of the Bank. During 2016/17, 10 RDPs were

Ego Pharmaceuticals Managing Director Alan Oppenheim (right) with Reserve Bank Victorian Office staff, May 2017

published on a range of topics, including: the household cash flow channel of monetary policy; measuring the uncertainty of the economic outlook; the cyclicality of the labour market; the interbank overnight cash market; productivity; and consumption. Reserve Bank staff also published their research in various external publications, including the *American Economic Journal: Economic Policy* and *The Economic Record*.

Research undertaken at the Reserve Bank is frequently presented at external conferences and seminars. In 2016/17, Bank staff presented at a number of conferences and institutions in Australia and overseas, including in Hong Kong, several European countries and China.

The Reserve Bank hosts regular conferences, which foster interaction between academics, central bankers and other economic practitioners on topical policy issues. The Bank's annual conference for 2017 was held in March and focused on monetary policy and financial

The Bank's annual conference focused on monetary policy and financial stability in a world of low interest rates

stability in a world of low interest rates. A volume containing the conference papers and discussions will be published in the second half of 2017. The next annual conference is scheduled for the first half of 2018.

The Reserve Bank also hosted visitors from a number of overseas organisations in 2016/17. Visitors from the United States included representatives from the Federal Reserve Bank of Cleveland, the Federal Reserve Bank of New York and the Federal Reserve Bank of St Louis. The Bank also welcomed visitors from the Bank of Japan, the Bank of Papua New Guinea, the Indonesian Ministry of Finance and the Bank of Lebanon. Meetings hosted by the Reserve Bank were attended by staff from a range of international bodies, including the International Monetary Fund and the Trans-Tasman Council on Banking Supervision. The Bank welcomed academics from overseas institutions, including Columbia University, Loughborough University, the Massachusetts Institute of Technology, Northwestern University, the University of Michigan and Université Toulouse 1 Capitole. These visitors presented seminars, taught short courses and participated in research activities at the Bank.

Public Communication

The Reserve Bank informs the public about policy decisions, analysis and the Bank's operations through its website, publications, speeches and media releases throughout the year.

Announcements about monetary policy decisions are made shortly after each Reserve Bank Board meeting and minutes are released two weeks after each meeting. A media release is published following Payments System Board meetings outlining issues discussed at the meeting and foreshadowing any forthcoming documents to be released by the Bank.

The quarterly *Statement on Monetary Policy* provides information about the Reserve Bank's assessment of current economic conditions, both domestic and international, along with the outlook for Australian inflation and output growth. The *Statement* contains a detailed analysis of conditions in the economy and financial markets and describes the outlook for inflation and the economy more generally.

The *Financial Stability Review*, published semiannually, provides a detailed assessment of the condition of Australia's financial system, along with analysis of financial system issues of special interest. In the year in review, focus areas included risks associated with residential mortgage lending, the impact of the mining sector adjustment on the commercial property and business sectors, and developments in overseas markets and emerging risks. The *Review* also reports on international regulatory developments and the Reserve Bank's involvement, and on domestic regulatory issues, including through the Bank's work with the CFR, which the Governor chairs.

Assistant Governor (Economic) Luci Ellis addresses the launch of the Women in Economics Network, March 2017

The Reserve Bank's quarterly *Bulletin* contains analysis of a broad range of economic and financial issues as well as aspects of the Bank's operations. During the year in review, the *Bulletin* contained articles on the labour market, developments in financial markets and regional variations in economic performance across Australia. Australia's housing market and the importance of inflation expectations for price stability were examined. There were also articles on various aspects of Chinese financial markets and the increasing sensitivity of Australian financial markets to news about the Chinese economy. Other articles reported on the results of the Reserve Bank's 2016 Consumer Payments Survey and the future of card, cash and cheque payments. Other topics explored in the *Bulletin* included trends in banknote counterfeiting, bank fees, bank funding costs, capital flows and the macroprudential policy framework.

During 2016/17, the Governor, Deputy Governor and other senior officers gave 47 public speeches on various topics. Questions were taken after almost all speeches. Senior staff also participated in a number of public panel discussions. In addition to communicating the Reserve Bank's analysis of domestic and global economic conditions, speeches covered the operation of Australia's flexible medium-term inflation target in a low-inflation environment, the FX Global Code, the Bank's new regulatory framework for surcharging of card payments and the changing nature of Australia's workforce. Senior officers also addressed the evolution of the Bank's work on financial stability, recent trends in Australian capital flows and the participation of women in

During 2016/17, the Governor, Deputy Governor and other senior officers gave 47 public speeches the economy and the economics profession. The Bank provided ongoing support to the Women in Economics Network, with Assistant Governor (Economic) Luci Ellis speaking at the network launch in Canberra in March 2017. Audio files of these speeches, the associated question and answer sessions and panel discussions were published on the Bank's website to facilitate transparency and accountability.

To assist further with public understanding of the Reserve Bank's role, in June 2017 the first event in the new Teacher Immersion Series was held, providing secondary school economics teachers with the opportunity to learn directly from, and about, the Bank. See the chapter on 'Community Engagement' for further details.

The Reserve Bank publishes information in both electronic and hard copy formats, though most access to information is now online. The Bank's website received around 125 million page views and downloads during 2016/17. Followers of the Reserve Bank's Twitter account, @RBAinfo, have grown in number to over 35 000, while the number of subscribers to the conventional email alert service has continued to fall (to less than 10 000 at the end of June 2017). Visitors to the website also made use of the RSS feeds, which allowed them to receive alerts about updates to selected data, media releases, speeches, research papers and other publications (including those related to Freedom of Information requests).

The Reserve Bank's website, which was substantially upgraded in 2015, continued to evolve during the year in review, with the addition of new videos, interactive elements and other features. The Banknotes microsite (www.banknotes.rba.gov.au) focuses on explaining the design, production and security features of Australia's banknotes. During 2016/17, it was further developed as an information and education resource in order

> In June 2017, the first event in the Reserve Bank's new Teacher Immersion Series was held

to provide information to the public and key stakeholders about the new banknote series being issued by the Bank and support the related communication campaign. The microsite, which provides resources in a number of engaging formats, such as interactive elements, videos, photos and promotional materials, has been an effective platform to share information about the new banknotes. The microsite received a significant increase in visitor traffic in the months following the release of the new $5 banknote in September 2016.

Operational Structure

The Reserve Bank has five operational groups – Business Services Group, Corporate Services Group, Economic Group, Financial Markets Group and Financial System Group – and five supporting departments.

The Reserve Bank is managed by the Governor, Philip Lowe*, who is the accountable authority, and the Deputy Governor, Guy Debelle*†.

Business Services Group

Assistant Governor: Lindsay Boulton*†

Business Services Group comprises Banking Department, Note Issue Department and Payments Settlements Department.

Banking Department

Head: Michelle McPhee

Deputy Heads: Bipan Arora, Stephanie Connors

Banking Department provides a range of banking services to Australian Government departments and agencies as well as a number of overseas central banks and official institutions. The services broadly comprise two activities – management of the government's core accounts and transactional banking. Sydney-based staff are responsible for the direction, administration and development of the department's work, while the day-to-day interaction with customers is largely managed by staff in the Canberra Branch.

Note Issue Department

Head: Michael Andersen

Deputy Heads: Keith Drayton, James Holloway

Note Issue Department is responsible for all aspects of the banknote lifecycle from research into and development of new banknote designs and security features, to the supply of high-quality banknotes to meet the community's needs. The department works with the Bank's wholly owned subsidiary, Note Printing Australia Limited (NPA), to design and produce the banknotes. (See below for information about the activities, governance and structure of NPA.) The department manages laboratories to assess new and used banknotes, develop new security features and assess counterfeits detected in circulation. It has an extensive public engagement program with commercial banks, retailers, cash-in-transit companies, law enforcement agencies and banknote equipment manufacturers. Staff actively participate in a number of international groups with the objective of minimising the threat posed by counterfeiters.

Payments Settlements Department

Head: Greg Johnston

Deputy Heads: David Brown, Peter Gallagher

Payments Settlements Department is responsible for the settlement of high-value payments and interbank obligations arising from the conduct of Exchange Settlement Accounts and the Reserve Bank's own trading activities, as well as operation of the Reserve Bank Information and Transfer System (RITS), Australia's real-time gross settlement system. Services are also provided for the clearing and settlement of low-value payments, such as those arising from cheque and direct entry transactions.

Corporate Services Group

Assistant Governor: Frank Campbell*†

Corporate Services Group comprises three departments that provide support functions for the Reserve Bank.

Facilities Management Department

Head: Bruce Harries (Acting)

Deputy Head: Ed Jacka (Acting)

Facilities Management Department is responsible for the Reserve Bank's properties, security management and a range of facility services.

Finance Department

Chief Financial Officer: Robert Middleton-Jones†

Financial Controller: Colleen Andersen

Finance Department prepares the Reserve Bank's financial and management accounts and is responsible for a range of staff services, including payroll, superannuation and travel. Finance also manages the Bank's Enterprise Portfolio Management Office.

Information Technology Department

Chief Information Officer: Sarv Girn†

Deputy Heads: Gayan Benedict, Peter Speranza

Information Technology Department is responsible for developing and maintaining reliable, resilient and secure information technology functions to support the Reserve Bank's policy, operational and corporate objectives.

Economic Group

Assistant Governor: Luci Ellis*

Economic Group is responsible for analysis of economic trends, both domestic and overseas, forecasting and research relevant to the framing of policy in the Reserve Bank's areas of responsibility. It consists of Economic Analysis Department and Economic Research Department.

Economic Analysis Department

Head: Alexandra Heath

Deputy Heads: Lynne Cockerell, Merylin Coombs, Michael Plumb

Economic Analysis Department monitors and forecasts trends in the domestic and international economies, provides regular advice on these developments and monetary policy to the Governors and the Reserve Bank Board, contributes to various external bodies, maintains contacts with relevant external analysts, undertakes applied research and prepares reports for publication.

The Reserve Bank maintains four State Offices to conduct economic liaison in Queensland, South Australia and the Northern Territory, Victoria and Tasmania, and Western Australia. New South Wales and the Australian Capital Territory are covered by Head Office. These offices analyse economic conditions in regions throughout Australia and conduct liaison with individual firms and agencies in both the private and public sectors. They also provide a vehicle for communicating the operation of monetary policy to the wider community.

The Reserve Bank has an office in Beijing, which is responsible for monitoring Chinese economic and financial developments as well as maintaining relationships with government and private entities in China.

Economic Research Department

Head: John Simon

Deputy Head: Adam Cagliarini

Economic Research Department undertakes longer-term research into issues relevant to the Reserve Bank's responsibilities, including research on the Australian economy, monetary policy, financial stability, the payments system and the operation of financial markets. Results of this research are published in the Research Discussion Paper series. The department organises a major annual conference and an annual Research Workshop. In addition, it organises a program of internal seminars, hosts a number of invited visitors each year and is responsible for administering a comprehensive library service for the Bank.

Financial Markets Group

Assistant Governor: Christopher Kent*†

Financial Markets Group is responsible for implementing the Reserve Bank's operations in domestic and foreign exchange markets, monitoring developments in financial markets and coordinating the Bank's relationships with international institutions. The group consists of Domestic Markets Department and International Department.

Domestic Markets Department

Head: Marion Kohler

Deputy Head: Ellis Connolly

Domestic Markets Department is responsible for the Reserve Bank's operations in the domestic money and bond markets. The department analyses developments in domestic financial markets, including the cost and availability of finance through financial intermediaries and capital markets, and provides regular advice to the Governors and the Reserve Bank Board on these issues.

International Department

Head: Chris Ryan

Deputy Heads: Susan Black (Acting), Matthew Boge

International Department is responsible for the Reserve Bank's foreign exchange operations, the investment of international reserve holdings of gold and foreign exchange, and the provision of regular advice on developments in international financial markets to the Governors and the Reserve Bank Board. The department is also responsible for maintaining the Bank's relations with a number of major international institutions.

The Representative Offices in London and New York come under the umbrella of the Financial Markets Group. The European Representative Office in London maintains liaison with central banks and other institutions and authorities in Europe, including the Bank for International Settlements and the Organisation for Economic Co-operation and Development. The New York Representative Office performs similar functions in North America. Both of these offices monitor economic and financial developments in their respective local markets, and assist with foreign exchange operations and investment of international reserves.

The Reserve Bank's investment and trading operations are supported by the Business Support Services area.

Financial System Group

Assistant Governor: Michele Bullock*

Financial System Group supports the Reserve Bank's broad responsibilities for financial system stability and its role in payments system oversight and regulation. The group consists of Financial Stability Department and Payments Policy Department and provides regular advice on policy matters to the Governors and the Reserve Bank and Payments System boards.

Financial Stability Department

Head: Jonathan Kearns

Deputy Heads: Darren Flood, David Orsmond

Financial Stability Department analyses the implications for financial system stability of developments in the macroeconomy, financial markets and the financial sector more generally, including areas such as patterns of financial intermediation, financial products and risk management techniques. The department provides advice on these issues to the Governors and the Reserve Bank Board and supports the Reserve Bank's representation on bodies such as the Council of Financial Regulators, the Financial Stability Board and the Basel Committee on Banking Supervision. It is responsible for producing the Bank's semiannual *Financial Stability Review*.

Payments Policy Department

Head: Tony Richards

Deputy Heads: Sarah Harris, Chris Thompson

Payments Policy Department is responsible for developing and implementing the Reserve Bank's payments system policy. It provides analysis and advice to the Payments System Board on improving the safety and efficiency of the payments system. The department is also responsible for oversight of Australia's high-value payments, clearing and settlement facilities and represents the Bank on the Committee on Payments and Market Infrastructures of the Bank for International Settlements.

Audit Department

Head: Darryl Ross[†‡]

Audit Department is responsible for conducting independent appraisals of the Reserve Bank's activities, functions and operations to ensure that an adequate framework of internal control has been established and is operating effectively. The Head of Audit Department reports to the Deputy Governor and the Chair of the Reserve Bank Board Audit Committee.

Human Resources Department

Head: Melissa Hope[*†]

Deputy Head: Michael Davies

Human Resources Department provides a range of people-related services to support the Reserve Bank in maintaining a productive and engaged workforce. This includes sourcing high-quality staff as well as implementing policies and programs that cover employment conditions, reward, development, diversity and workplace health and safety.

Information Department

Head: Jacqui Dwyer[†‡]

Information Department is responsible for the Reserve Bank's records management system, information governance, its archives and facilitating public access to Bank records. It also manages the Reserve Bank of Australia Museum and a program of public education, with particular focus on supporting students and educators.

Risk and Compliance Department

Head: Chris Aylmer[†‡]

Risk and Compliance Department supports the consistent and effective application of the Reserve Bank's framework for managing risk, both at the enterprise level and for individual business units. It assists departments to identify, understand and manage their compliance obligations. It also monitors and reports on portfolio risks and compliance with respect to the Bank's operations in financial markets.

The Head of Risk and Compliance Department reports to the Deputy Governor. The department is responsible for secretariat services for the Risk Management Committee.

Secretary's Department

Secretary: Anthony Dickman*

Deputy Secretary: Andrea Brischetto

General Counsel: Catherine Parr†‡

Deputy General Counsel: Peter Jones

Secretary's Department provides secretariat and coordination services and advice on governance matters for the Governors, the Reserve Bank Board and its Audit and Remuneration committees, the Payments System Board and the Executive Committee. Secretary's Department is responsible for preparing and publishing Reserve Bank information and maintaining the Bank's websites. The department handles enquiries from the public and media. In addition, it provides legal services to the Bank through the General Counsel (who reports directly to the Deputy Governor), coordinates a range of contacts with government, the parliament, other central banks and international organisations, and arranges programs for visitors.

Wholly owned subsidiary: Note Printing Australia Limited (NPA)

NPA is a wholly owned subsidiary of the Reserve Bank that produces banknotes and operated the National Note Processing and Distribution Centre on behalf of the Bank until 16 February 2017, when the Bank resumed responsibility for the processing operations. NPA operates under a charter reviewed and approved annually by the Reserve Bank Board.

NPA's prime function is the efficient and cost-effective production of high-quality and secure Australian banknotes, in accordance with the specifications and requirements of the Reserve Bank. NPA also undertakes other activities, including developing and producing passports for the Department of Foreign Affairs and Trade, producing banknotes for other issuing authorities and producing some other security products.

NPA is governed by a Board of Directors appointed by the Reserve Bank. As at the date of this report, the Board comprised three Reserve Bank executives, and one current and one former member of the Reserve Bank Board: Chris Aylmer (Head of Risk and Compliance Department) as Chair; Michelle McPhee (Head of Banking Department); Robert Middleton-Jones (Chief Financial Officer); Kathryn Fagg, a member of the Reserve Bank Board; and Heather Ridout AO, a former member of the Reserve Bank Board. The NPA Board has an Audit and Risk Committee, whose membership comprises Michelle McPhee (Chair), Robert Middleton-Jones and an external member, Alan Beckett, a company director and former senior audit partner of a major accounting firm with extensive experience in the corporate sector, including manufacturing.

NPA's Executive Committee, comprising its Chief Executive Officer and the heads of NPA's eight business areas, is responsible for the operational and administrative management of NPA. As at the end of June 2017, NPA employed 250 permanent staff.

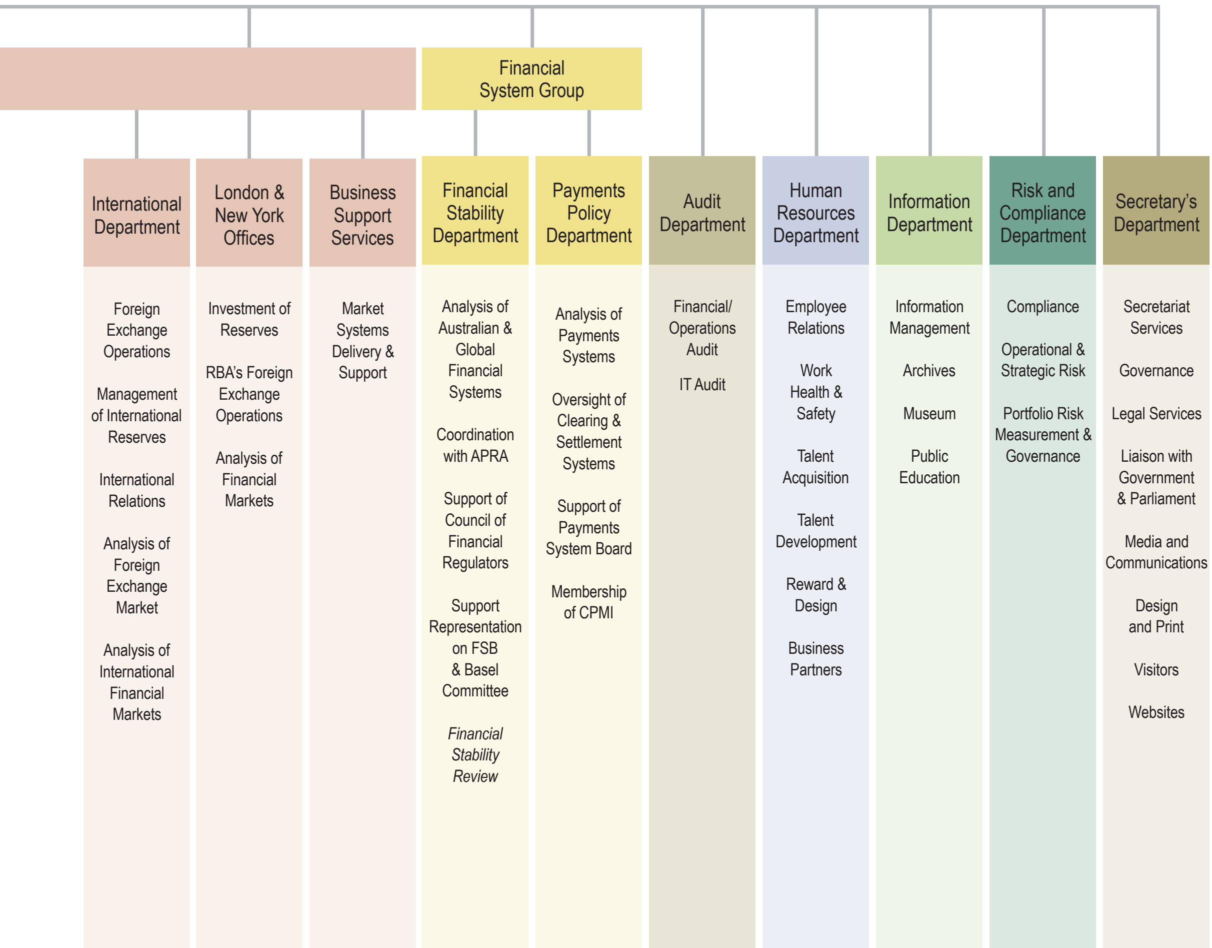
The financial accounts of NPA are consolidated with those of the Reserve Bank.

* Member of Executive Committee
† Member of Risk Management Committee
‡ Advisor to Executive Committee

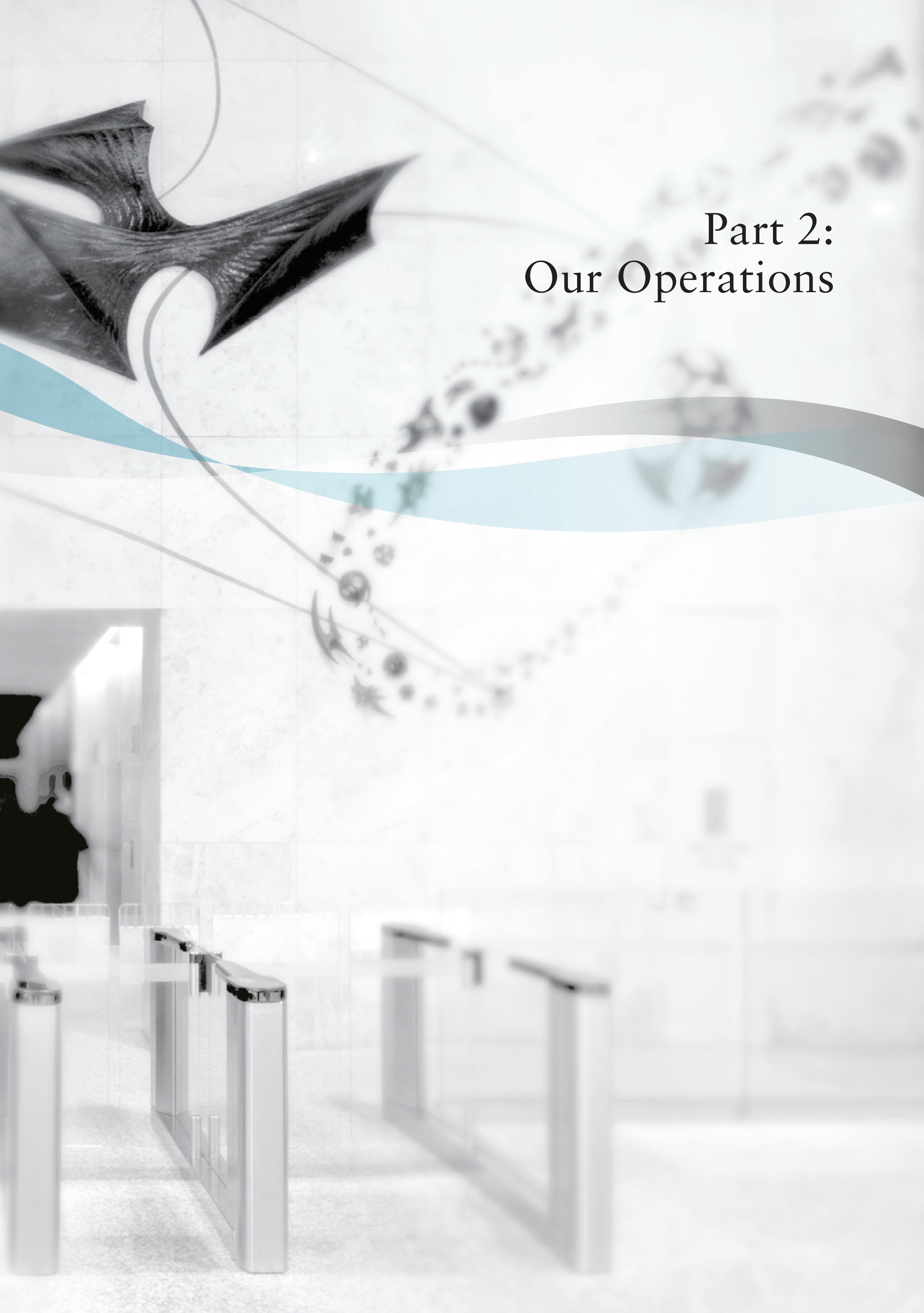
Reserve Bank of Australia Operational Structure

16 August 2017

- **Governor**
  - **Deputy Governor**
    - Business Services Group
      - Banking Department
        - Service Delivery
        - Policy and Strategy
        - Business Systems
        - Banking Projects
        - Canberra Branch
      - Note Issue Department
        - Banknote Research
        - Banknote Quality
        - External Relations
        - Counterfeit Analysis
        - Banknote Distribution
        - Next Generation Banknote Program
      - Payments Settlements Department
        - Business Policy & Services
        - Payment System Operations
        - Payment System Projects
        - Settlements
    - Corporate Services Group
      - Facilities Management Department
        - Property Management
        - Physical Security
        - Facilities Services
        - Projects
      - Finance Department
        - Financial Control
        - Enterprise Portfolio Management Office (EPMO)
        - Shared Services – Payroll – Travel
        - Superannuation Fund
      - Information Technology Department
        - Policy & Markets Systems
        - Banking Systems
        - Currency Systems
        - Payments Systems
        - Enterprise Systems
        - Security Services
        - Operational Services
        - Infrastructure Services
        - Strategy, Architecture & Governance
    - Economic Group
      - Economic Analysis Department
        - Advice on Monetary Policy
        - Analysis of Australian & International Economies
        - Forecasting
        - State Offices
        - China Office
        - *Statement on Monetary Policy*
      - Economic Research Department
        - Economic Research
        - Conferences
        - Research Discussion Papers
        - Research Library
    - Financial Markets Group
      - Domestic Markets Department
        - Market Operations
        - Liquidity Forecasts
        - Analysis of Intermediated Markets
        - Analysis of Securities Markets


Financial System Group
International Department
Foreign Exchange Operations
Management of International Reserves
International Relations
Analysis of Foreign Exchange Market
Analysis of International Financial Markets
London & New York Offices
Investment of Reserves
RBA's Foreign Exchange Operations
Analysis of Financial Markets
Business Support Services
Market Systems Delivery & Support
Financial Stability Department
Analysis of Australian & Global Financial Systems
Coordination with APRA
Support of Council of Financial Regulators
Support Representation on FSB & Basel Committee
Financial Stability Review
Payments Policy Department
Analysis of Payments Systems
Oversight of Clearing & Settlement Systems
Support of Payments System Board
Membership of CPMI
Audit Department
Financial/ Operations Audit
IT Audit
Human Resources Department
Employee Relations
Work Health & Safety
Talent Acquisition
Talent Development
Reward & Design
Business Partners
Information Department
Information Management
Archives
Museum
Public Education
Risk and Compliance Department
Compliance
Operational & Strategic Risk
Portfolio Risk Measurement & Governance
Secretary's Department
Secretariat Services
Governance
Legal Services
Liaison with Government & Parliament
Media and Communications
Design and Print
Visitors
Websites

Part 2:
Our Operations

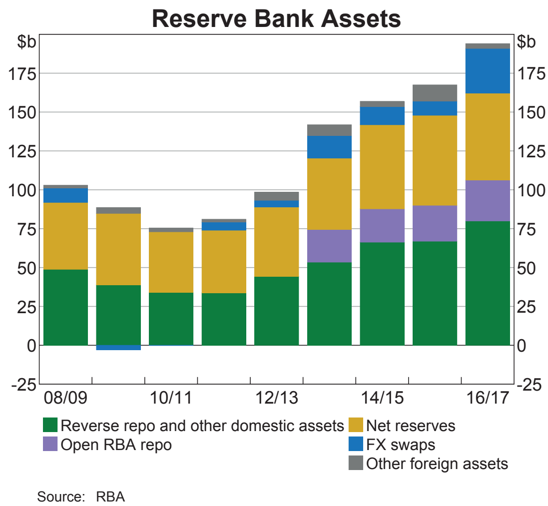


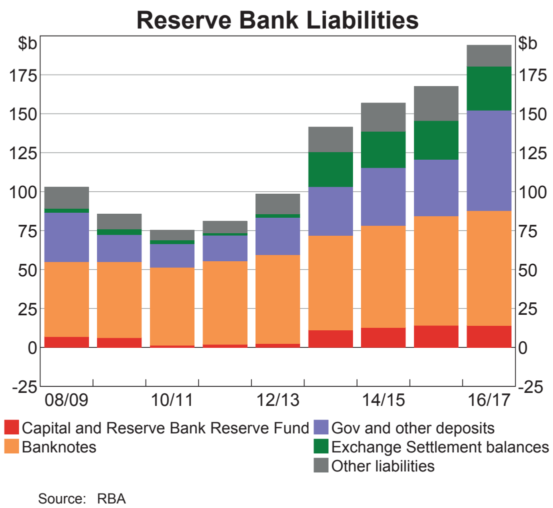
Operations in Financial Markets

The Reserve Bank operates in domestic and international financial markets in order to meet the Bank's policy objectives. These include implementing the monetary policy decisions of the Reserve Bank Board, facilitating the smooth functioning of the payments system, managing the nation's foreign exchange reserve assets and providing banking services to clients (mainly the Australian Government and foreign central banks).

Balance Sheet

Over the past year, the Reserve Bank's balance sheet expanded by $27 billion to around $194 billion. On the liabilities side of the balance sheet, the increase largely reflected a rise in funds held on deposit by the Australian Government. These deposits vary considerably over the course of the year as a result of the pattern of government receipts and expenditure. Banknotes on issue grew by around $3 billion, broadly in line with the increase seen in recent years. To offset the withdrawal of liquidity from the financial system arising from these transactions, the Reserve Bank increased its holdings of domestic securities held under reverse repurchase agreement (repo) and foreign exchange swaps.





Domestic Market Operations

Monetary policy implementation

The Reserve Bank Board's operational target for monetary policy is the cash rate – the rate at which banks borrow and lend to each other on an overnight, unsecured basis. The cash rate is a significant financial benchmark referenced

The Reserve Bank's balance sheet was around $194 billion

in overnight indexed swaps and ASX's 30-day interbank cash rate futures contract. The Board adjusted the cash rate target once during 2016/17, from 1.75 per cent to 1.5 per cent in August 2016. During 2016/17, the daily liquidity management operations of the Reserve Bank were conducted so as to ensure that the cash rate remained consistent with the target set by the Board on all days.

The Reserve Bank is also responsible for calculating the cash rate. The Bank calculates the cash rate directly from market transactions, sourcing individual transaction data from the Reserve Bank Information and Transfer System (RITS). In 2016/17, there were around 35 cash market transactions each day, with aggregate daily activity in the cash market averaging around $4.5 billion.

The funds traded in the cash market are the balances held by financial institutions in their Exchange Settlement Accounts (ESAs) at the Reserve Bank. These accounts are held by around 95 financial institutions and are used to settle payment obligations between these institutions. The aggregate level of Exchange Settlement (ES) balances changes as a result of transactions between customers of the Bank (principally the Australian Government) and ESA holders. The Bank also undertakes transactions on its own behalf to affect the level of ES balances. This includes undertaking repos collateralised with eligible securities, buying or selling government securities on an outright basis, or using foreign exchange swaps involving Australian dollars. The Bank conducts these transactions with a view to maintaining the aggregate level of ES balances consistent with demand at the cash rate target.

The bulk of ES balances arise from 'open repos' (that is, repos contracted without a maturity date) contracted with the Reserve Bank by financial institutions to meet their liquidity needs outside of normal banking hours. As these balances are remunerated at the cash rate target and are held to facilitate the smooth operation of the payments system, they have no implications for the implementation of monetary policy. At the end of June 2017, these balances were $26 billion.

The remainder of ES balances, referred to as surplus ES balances, were steady at around $2 billion during 2016/17. These surplus balances are remunerated at a level that is 25 basis points below the cash rate target, and therefore ESA holders typically aim to maintain their accounts with a small positive (surplus) balance. Day-to-day demand for these surplus ES balances can be volatile for a number of reasons, including because, at times, some institutions choose to hold ES balances as high-quality liquid assets to comply with the Liquidity Coverage Ratio (LCR) framework. There can also be seasonal demand for liquidity around the end of each calendar quarter.

During 2016/17, the cash rate remained consistent with the target set by the Board on all days

Open market operations

On a day-to-day basis, the Reserve Bank transacts in domestic markets to offset the effect on the supply of ES balances arising from payment flows between ESA holders and the Bank, and to accommodate changes in aggregate demand for ES balances by financial institutions. Most of the Bank's transactions in the domestic market are reverse repos contracted as part of its regular morning open market operations.[1] In conducting its operations, the Bank takes account of forecast changes in liquidity, as well as the pricing of the bids and offers received against prevailing market rates. In 2016/17, the repo transactions conducted in these operations had an average maturity at origination of around 35 days, and a maximum term of around six months. Reflecting the role that repos play in managing system liquidity, the size of the Bank's repo book ranged between $47 billion and $64 billion during the financial year.

To ensure that unexpected payment flows during the day do not adversely affect the cash rate, the Reserve Bank has the option of undertaking additional rounds of market operations in the late afternoon. Such additional rounds were announced, on average, five times per month during 2016/17, with 60 per cent of these operations offering to inject additional liquidity into the system. Terms for these operations are much shorter than the morning operations, with a maximum term of 11 days in 2016/17. In the event of unforeseen liquidity developments in the evening, further additional rounds can be announced if the need arises, although no such operations were conducted in 2016/17.

In March 2017, the Reserve Bank launched a new dealing system to conduct its open market operations. Prior to this new system, a number of manual processes were required to set up the Bank's dealing rounds, and individual counterparties were notified of their results by telephone shortly after the conclusion of the operation. The new system automates these processes, including publishing the Bank's dealing intentions to the market data services, creating transaction exposures in the Bank's treasury management system and electronically notifying individual counterparties of their results.

Over recent years, the Reserve Bank has increased its use of foreign exchange swaps when managing system liquidity (swapping Australian dollars for foreign currencies alters the supply of ES balances in the same way as a repo transaction).[2] This has been necessitated by the limited capacity of the domestic repo market to absorb large fluctuations in the Bank's positions, such as those associated with large maturities of Australian Government Securities (AGS). Compared with the Australian repo market, the foreign exchange swap market has greater depth and liquidity. Reflecting the role of the Bank's foreign exchange swaps in assisting with short-term liquidity management, these swaps have typically been contracted at maturities of three months or fewer.

The Reserve Bank also purchases government securities on an outright basis to assist in the management of large AGS maturities. This reflects the Bank's need to mitigate the liquidity impact on the maturity date of the funds that are paid out of the Australian Government's account at the Bank into ESAs (for the credit of the security holder). These purchases are carried out using near-to-maturity securities and for liquidity management purposes. They have no implications for the stance of monetary policy. To offset the liquidity effect

1 A reverse repo involves an agreement to buy and then later sell securities; this is economically similar to a secured loan, with the difference between the purchase and sale price representing the interest earned on the transaction.

2 While the use of foreign exchange swaps increases the Reserve Bank's holdings of foreign exchange, it has no effect on net foreign reserves, as the increased holdings of foreign exchange are matched with a commitment to sell foreign exchange at a pre-determined price and date. For the same reason, the use of swaps has no effect on the exchange rate.

of AGS maturities, the Bank purchased $13 billion of the February 2017 bond prior to its maturity. In preparation for the large AGS maturities scheduled for 2017/18, by the end of June 2017 the Bank had purchased $8.9 billion of the July 2017 bond and $6.8 billion of the January 2018 bond. The Bank's outright holdings of AGS are published monthly on the Bank's website.

The Reserve Bank also holds a small amount of longer-term semi-government securities (semis) on an outright basis in its domestic portfolio. These are available to be sold as collateral under repo. At the end of the financial year, the Bank held around $2.5 billion of semis on an outright basis. These securities are generally purchased as part of the Bank's daily open market operations or separately through outright purchase operations. The latter, which are conducted over the Yieldbroker DEBTS trading platform, occurred four times in 2016/17.

The Reserve Bank continues to operate a Securities Lending Facility on behalf of the Australian Office of Financial Management. The securities available through the facility comprise all Treasury Bonds and Treasury Indexed Bonds currently on issue. The Bank sells these securities either for intraday or open repos to RITS members eligible to participate in the Bank's domestic market operations.

Standing facilities

Separate from its open market operations, the Reserve Bank also provides certain standing facilities, primarily to support the functioning of the payments system. Through these facilities, eligible counterparties transact with the Bank on pre-arranged terms, with liquidity made available via repos. The most frequently used standing facilities are those for the provision of intraday liquidity to ESA holders. The Bank can also extend overnight funding via repo where an ESA holder faces a shortage in ES balances that cannot be borrowed from another financial institution; such funding is extended at an interest rate 25 basis points above the cash rate target. During 2016/17, ESA holders accessed overnight funding from the Bank on three occasions.

Open repos are provided under the Reserve Bank's standing facilities for ESA holders that have to settle payment obligations outside normal business hours, such as 'direct-entry' payments. Open repos will also be used to facilitate the settlement of after-hours transactions through the New Payments Platform. As at the end of June 2017, 15 financial institutions had open repo positions with the Bank, valued at around $26 billion. These amounts were increased by $4 billion in February 2017 to cater for growth in direct-entry payments after normal business hours. To collateralise these open repos, the Bank has permitted the use of certain related-party assets issued by bankruptcy remote vehicles, such as self-securitised residential mortgage-backed securities (RMBS).

Eligible securities

The Reserve Bank has established criteria that determine which securities are eligible to be purchased under repo in the Bank's domestic market operations. To protect against a decline in the value of the collateral securities should the Bank's counterparty not meet its repurchase obligation, the Bank requires the value of the security to exceed the cash lent by a certain margin. These margins, which are listed on the Bank's website, are considerably higher for securities that are not issued by governments.[3] From time to time, the Bank reviews its eligibility criteria and the margin schedule. In June 2017, the Bank widened the eligibility criteria for longer-term securities issued by authorised deposit-taking institutions (ADIs) to include all those in a broader investment grade 'BBB basket';

3 See <https://www.rba.gov.au/mkt-operations/resources/tech-notes/eligible-securities.html>.

prior to this review, such securities needed to have a minimum credit rating of BBB+ to be eligible. In order to ensure that the risks of purchasing lower-rated securities under repo are managed appropriately, the margins applied to securities in this basket were increased.

Participants in the Reserve Bank's market operations tend to be the fixed-income trading desks of banks and securities firms seeking to finance their inventories of AGS and semis, as well as bank treasuries. Reflecting this, over half of the securities held by the Bank (excluding those under open repo) are government-related obligations, with most of the remainder being bank-issued debt securities and RMBS.

Domestic securities purchased by the Reserve Bank are held for safe custody in an account that the Bank maintains in Austraclear, the securities depository and registry operated by ASX. Securities transactions conducted between the Bank and its counterparties are settled in the Austraclear system, mostly on a bilateral basis. The Bank also settles repo transactions contracted in its open market operations within ASX Collateral, a collateral management service. During 2016/17, around 20 per cent of the total amount of securities the Bank purchased under repo was settled within ASX Collateral, up from around 10 per cent in 2015/16.

Asset-backed securities form a significant share of the collateral securities the Reserve Bank purchases under open repo. Around 95 per cent of the outstanding amount of open repos is backed by self-securitised RMBS. Asset-backed securities – particularly self-securitised RMBS – are also the major asset provided as collateral for the Committed Liquidity Facility (CLF). Self-securitised RMBS used in open repos do not have directly observable market prices, as they are retained in full by the bankruptcy remote trusts of originating institutions and are therefore not traded. As a result, the Bank uses an internal valuation model for self-securitised RMBS based on observed market prices of similarly structured RMBS; this internal model is externally reviewed.

Given the importance of asset-backed securities to the Reserve Bank's operations, the Bank has mandatory reporting requirements for securitisations to remain eligible for repo. In 2016/17, the Bank received around 3 600 monthly

Australian Dollar Securities Held under Repurchase Agreements[(a)]

	June 2015		June 2016		June 2017	
	$ billion	Per cent of total	$ billion	Per cent of total	$ billion	Per cent of total
AGS	22.8	28	32.8	35	43.8	43
Semis	11.3	14	7.4	8	6.2	6
Supranational	4.7	6	3.4	4	3.5	3
Government guaranteed	0.0	0	0.0	0	0.0	0
ADI issued	16.1	20	16.8	18	12.5	12
Asset-backed securities	25.3	31	31.6	34	35.6	35
Of which for open repo	24.1	30	27.2	29	33.5	33
Other	0.1	0	0.6	1	0.6	1
Total	80.3	100	92.5	100	102.2	100
Of which for open repo	25.6	32	29.3	32	35.7	35

(a) Market value of securities before the application of margins; includes securities held under triparty repurchase agreements
Source: CEIC; RBA

data submissions on around 300 asset-backed transactions from issuers or their appointed information providers. For eligible RMBS, this covers around two million underlying individual housing loans with a combined balance of around $400 billion, which is around one-quarter of the total value of housing loans in Australia. The required data include key information on the structure of the RMBS and the relationships among counterparties within the RMBS structure; the required data also include information on the residential mortgage loans and the underlying collateral backing the RMBS structure.

Reflecting the Reserve Bank's interest in promoting increased transparency for investors in asset-backed securities, issuers are also required to make securitisations information available to investors and other permitted users. The data provided to these users are broadly similar to the data provided to the Bank; however, issuers may redact particular fields where the information poses a potential risk to privacy obligations and provide aggregated data instead.

The mandatory reporting requirements allow the Reserve Bank (and other investors in RMBS) to analyse in detail the underlying risks in asset-backed securities and to price and manage risk for such securities accurately.[4]

Committed Liquidity Facility

Banks subject to the LCR under the Basel III liquidity standard are required to hold sufficient high-quality liquid assets (HQLA, which consist of AGS and semis) to meet outflows during a 30-day period of stress. Given the relatively low levels of government debt in Australia, there is a shortage of HQLA securities. To address this, the Reserve Bank provides the CLF, which is a contractual commitment to funding under repo with the Reserve Bank, subject to certain conditions. These conditions include a fee that banks pay of 15 basis points per annum on the amount committed and that any bank seeking to utilise the CLF must have positive net worth in the opinion of the Reserve Bank, having consulted with the Australian Prudential Regulation Authority (APRA). The banks are able to contract these repos using securities eligible in the Reserve Bank's domestic market operations. The full terms and conditions of the facility are available on the Bank's website.[5]

The Reserve Bank administers the CLF, while APRA determines which banks have access and the amount available (in aggregate and to each bank). During 2016/17, 14 banks were permitted to access the CLF. The aggregate size of the CLF is the difference between APRA's assessment of banks' overall LCR requirements and the Reserve Bank's assessment of the amount of HQLA securities that could reasonably be held by banks without unduly affecting market functioning. For 2017, APRA assessed banks' overall LCR requirements to be $437 billion and the Reserve Bank assessed the banks' reasonable holdings of HQLA securities to be $220 billion, such that the total size of the CLF was $217 billion. This was $29 billion lower than the total size of the CLF in 2016, largely reflecting an increase in the value of HQLA securities that banks could reasonably hold. For 2018, the Reserve Bank has assessed that banks can reasonably hold $226 billion of HQLA securities.

Foreign Exchange Operations

The Reserve Bank transacts in the foreign exchange market on almost every business day. The majority of these transactions are associated with providing foreign exchange services to the Bank's clients, the most significant of which

4 Some analysis of the securitisations data was included in a speech by Chris Aylmer, in his previous role as Head of Domestic Markets Department, in November 2016. See <https://www.rba.gov.au/speeches/2016/sp-so-2016-11-22.html>.

5 The CLF legal documentation is available at <https://www.rba.gov.au/mkt-operations/resources/tech-notes/pdf/clf-terms-and-conditions.pdf> and <https://www.rba.gov.au/mkt-operations/resources/tech-notes/clf-operational-notes.html>.

is the Australian Government. During 2016/17, the Bank sold $9 billion of foreign currency to the government (not including sales related to International Monetary Fund (IMF) financing).

The Reserve Bank sources foreign currency for its customers through purchases in the spot market. The Bank has the option – during periods of market stress – to use its existing stock of foreign currency reserves to fund its customer business, subsequently replenishing those reserves when market conditions have stabilised. However, using foreign currency reserves in this manner has not been considered necessary since 2008, at which time global financial market functioning was significantly impaired. Similarly, the Bank has not intervened in the foreign exchange market since 2008. During 2016/17, the Bank's assessment was that trading conditions in the market were sufficiently orderly and it was not necessary for the Bank to support liquidity in the market through its own transactions. The Bank nevertheless retains the discretion to intervene in the foreign exchange market to address any apparent dysfunction and/or a significant misalignment in the value of the Australian dollar. Intervention data are published, with a lag, on the Bank's website.

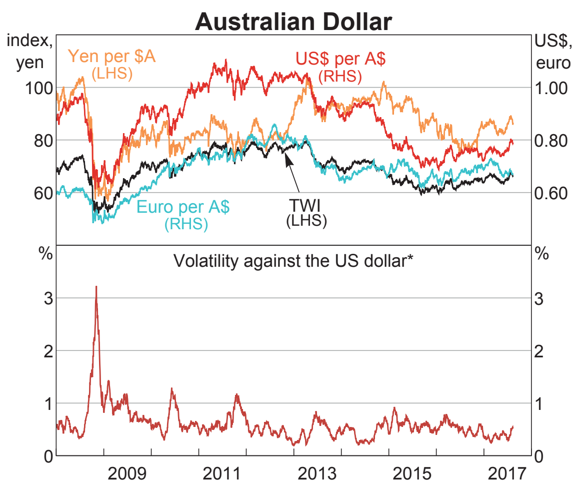
The Reserve Bank also transacts in the foreign exchange market when managing its foreign currency reserves. As discussed below, the relative weightings of foreign currencies in the Bank's portfolio are tightly managed against a benchmark. To maintain the portfolio at these benchmark weights, or to accommodate discrete changes in the weights, the Bank will transact in spot foreign exchange markets. The final settlement of these rebalancing flows may be deferred through the use of foreign exchange swaps, whereby one currency is exchanged for another with a commitment to unwind the exchange at a subsequent date at an agreed (forward) rate. Swaps can also be an efficient way to manage the shorter-term investments within

The total size of the CLF was $217 billion

the reserves portfolio. During 2016/17, swaps transacted for these purposes totalled around $89 billion.

As discussed above, the Reserve Bank also makes use of foreign exchange swaps in its domestic market operations. Swapping Australian dollars for foreign currencies does not affect the exchange rate, but alters the supply of ES balances in the same way as the Bank's repo transactions. The swap market generally offers more liquidity than the domestic repo market, allowing the Bank to better manage the impact of large projected changes in ES balances (such as those associated with government bond maturities). In 2016/17, $126 billion of foreign exchange swaps were undertaken for domestic liquidity management.

Foreign currency swaps executed by the Reserve Bank are generally for no more than three months' duration. The resulting forward foreign



* Daily absolute percentage change, 22-day rolling average
Sources: RBA; Thomson Reuters

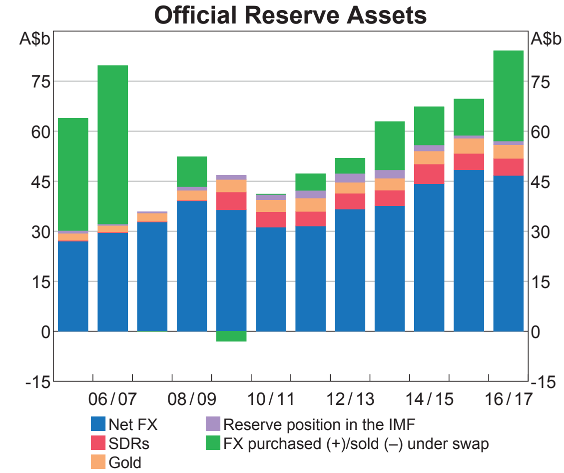
Net foreign currency assets were US$35.9 billion

exchange positions with each of the Bank's counterparties are marked to market daily and collateral is held against net exposures. The terms under which collateral is exchanged are defined in two-way credit support annexes to the International Swaps and Derivatives Association (ISDA) Master Agreements, which the Bank has executed with each of its counterparties (see the chapter on 'Risk Management').

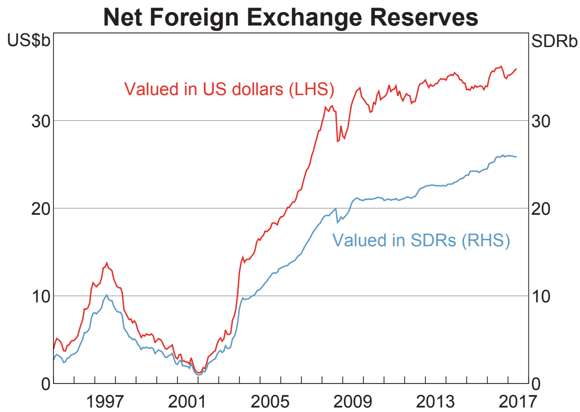
Reserves management

Australia's official reserve assets include foreign currency assets, gold, Special Drawing Rights (SDRs – an international reserve asset created by the IMF) and Australia's reserve position in the IMF. At 30 June 2017, these assets totalled $84.1 billion. All components of official reserve assets are owned and managed by the Reserve Bank with the exception of Australia's reserve position in the IMF, which is an asset of the Australian Government.

Official reserve assets are held by the Reserve Bank to facilitate various policy operations, including in the foreign exchange market (described above) and to assist the Australian Government in meeting its commitments to the IMF (discussed below). The Bank's capacity to undertake such operations is best measured by its foreign currency holdings net of any forward commitments (such as foreign currency the Bank has obtained from short-term swaps against



Source: RBA



Source: RBA

the Australian dollar). As at 30 June 2017, net foreign currency assets were SDR25.8 billion and US$35.9 billion. (In Australian dollar terms, net foreign currency assets totalled $46.7 billion, a decrease of $1.7 billion from 12 months earlier, reflecting valuation effects.) The amount held represents the level assessed as necessary to meet policy requirements.

To ensure a strong balance sheet, the Reserve Bank holds capital against certain risks arising from its reserve assets (see the chapter on 'Earnings, Distribution and Capital' for more detail). These asset holdings can expose the Bank to market, liquidity and credit risk, which the Bank seeks to

Benchmark Foreign Currency Portfolio
30 June 2017

	US dollar	Euro	Japanese yen	Canadian dollar	Chinese renminbi	UK pound sterling	South Korean won
Currency allocation (per cent of total)	55	20	5	5	5	5	5
Duration (months)	6	6	6	6	18	3	18

Source: RBA

mitigate where possible, such as by holding a diversified portfolio and investing only in assets of high credit quality and appropriate liquidity (see the chapter on 'Risk Management' for more detail).

The composition of the Reserve Bank's net foreign currency assets is managed against an internally constructed benchmark. This benchmark is assessed to be the combination of foreign currencies and foreign currency assets that maximises the Bank's expected returns over the long run, subject to the Bank's tolerance for risk. The structure of the benchmark is reviewed periodically and in response to significant changes in market conditions.

During 2016/17, no changes were made to the currency allocation of the benchmark portfolio. The Reserve Bank maintains the largest allocation to the US dollar at 55 per cent, reflecting the significant liquidity in the US dollar currency and asset markets.

Reflecting the generally low level of global interest rates, duration targets have remained short for most of the foreign currency portfolios. Short duration targets mitigate the risk of capital losses in the event that yields in these currencies increase in the future.

Investments in the benchmark currencies are limited to deposits at official institutions (such as central banks) and debt instruments issued (or guaranteed) by sovereign entities, central banks and supranational agencies. Debt instruments issued by quasi-sovereign entities can also be accepted as collateral under reverse repos.

Sovereign credit exposures are currently limited to the United States, Germany, France, the Netherlands, Canada, Japan, China, the United Kingdom and South Korea.

At the end of June 2017, the Reserve Bank's foreign currency reserves included $27.5 billion of foreign currency sourced from swaps against Australian dollars. Foreign currency obtained in this manner does not comprise part of the benchmark portfolio but reflects domestic liquidity operations. It is invested to ensure that the Bank's forward commitments to sell foreign currency are hedged against currency and interest rate risk.

As has been the case for some years, when the cost of hedging currency risk is taken into account, yields on short-dated Japanese investments have generally exceeded those available in the other currencies in the Reserve Bank's portfolio. Reflecting this, the bulk of the foreign currency the Bank obtains from swaps against Australian dollars is Japanese yen.

For the same reason, the Reserve Bank also swaps other currencies in its foreign exchange reserves portfolio against the yen to enhance returns. As a consequence, while the Bank's exposure to changes in the value of the yen remains small (consistent with the yen's 5 per cent allocation in the benchmark), an additional $19.6 billion of yen was held at the end of June 2017 as a result of swaps against other foreign currencies in the portfolio.

A small component of the Reserve Bank's net foreign currency reserves sits outside the

Foreign Currency Assets[a]

A$ million, 30 June 2017

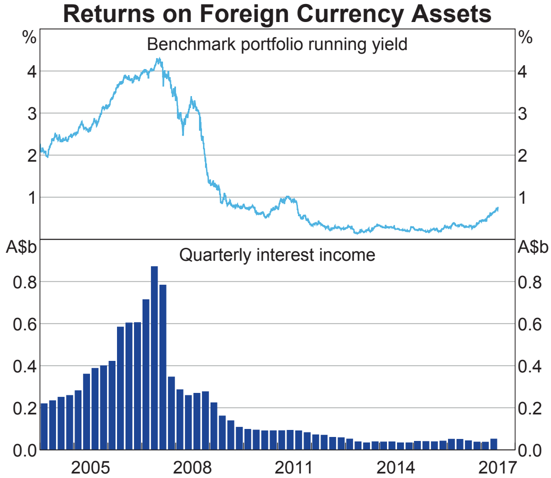
Currency	Securities held outright	Securities held under reverse repurchase agreements	Deposits at official institutions[b]	Total (gross)	Forward foreign exchange commitments		Total (net)
					Against AUD	Against other currencies[c]	
US dollar	10 284	1 858	912	13 053	8	12 279	25 340
Euro	2 772	–	1 117	3 889	0	5 391	9 280
Japanese yen	30 381	696	18 283	49 361	–27 497	–19 642	2 222
Canadian dollar	1 383	–	5	1 387	–	942	2 329
Chinese renminbi	2 193	–	117	2 310	–	–	2 310
UK pound sterling	846	–	1	847	0	1 489	2 336
South Korean won	2 287	–	2	2 289	–	–	2 289
Total	**50 147**	**2 554**	**20 436**	**73 137**	**–27 489**	**459**	**46 107**

(a) Excludes investments in the Asian Bond Fund
(b) Includes deposits at foreign central banks and the Bank for International Settlements
(c) In accordance with IMF guidelines, 'forward commitments' reflect notional values of unsettled spot and forward transactions, converted to Australian dollars at the prevailing forward exchange rate
Source: RBA

benchmark framework. This encompasses investments in a number of Asian debt markets through participation in the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) Asian Bond Fund Initiative. This initiative was established following the Asian currency crisis in the late 1990s to assist in the development of bond markets in the region. At the end of June 2017, the total allocation of the Bank's reserves to these funds was $596 million and the return on these investments in 2016/17 was –0.7 per cent when measured in SDR terms, because of capital losses on bond holdings and the depreciation of some Asian currencies.

Measured in SDRs, the overall return on the Reserve Bank's foreign currency assets over 2016/17 was 1.0 per cent, slightly lower than the previous year but broadly in line with the average since 2011/12. This outcome reflected small contributions from interest income and exchange rate valuation effects, which were partially offset by capital losses on bond holdings. The running yield on the benchmark portfolio remained low at around 0.8 per cent, reflecting low or negative bond yields in a number of the major economies.

Returns on Foreign Currency Assets



Source: RBA

The Reserve Bank's holdings of SDRs at 30 June 2017 amounted to $5.1 billion, $0.2 billion higher than the previous year, as its net purchases of SDRs over the year more than offset the impact of the appreciation of the Australian dollar against the SDR. Under voluntary arrangements with the IMF, the Bank is willing to transact in SDRs upon request from other countries or prescribed holders. In these transactions, the Bank will generally either buy or sell SDRs in exchange for foreign currencies (such as euros or US dollars). While such transactions do not alter the level of Australia's reserve assets (only the respective proportions held in SDRs and foreign currency), the Bank occasionally chooses to replenish foreign currency sold in exchange for SDRs by purchasing additional foreign currency against Australian dollars in the spot market.

Australia's reserve position in the IMF comprises that part of Australia's quota in the IMF that is paid in foreign currency as well as other credit that Australia has extended to the IMF in support of its lending programs. At the end of June 2017, Australia's reserve position in the IMF was $1.1 billion, which was $251 million higher than the previous year. As noted above, Australia's reserve position in the IMF is not held on the Reserve Bank's balance sheet. However, the Bank will sell to (or purchase from) the Australian Treasury the foreign currency the Treasury needs to complete its transactions with the IMF. In contrast to other foreign exchange transactions with the Australian Government, the Bank will typically draw on (or add to) its foreign currency reserves when providing (or receiving) foreign currency for IMF-related purposes. Nevertheless, as with SDR transactions, on certain occasions the Bank may decide to offset the impact on foreign currency holdings of these IMF transactions by buying or selling foreign currency in exchange for Australian dollars in the spot market.

The running yield on the benchmark portfolio remained low at 0.8 per cent

Gold holdings at the end of June 2017 were around 80 tonnes, unchanged from the previous year. Gold prices fell by 9.2 per cent in Australian dollar terms in 2016/17, decreasing the value of the Reserve Bank's holdings of gold by around $0.4 billion to $4.1 billion. At $0.74 million, income from gold loans was slightly higher than in recent years, as the Bank increased its lending activity marginally.

Bilateral currency swaps

In February 2017, the Reserve Bank renewed a bilateral local currency swap agreement with the Bank of Korea. The agreement allows for the exchange of local currencies between the two central banks of up to $10 billion or KRW 9 trillion. The agreement is for a further three years and can be extended by mutual consent. The Reserve Bank has similar agreements with the People's Bank of China, the Bank of Japan and Bank Indonesia. The purpose of these agreements is to allow each central bank to support trade settlement in local currencies, particularly in times of market stress, or to support financial stability.

Banking and Payment Services

The Reserve Bank provides banking and payment services that underpin the efficient and stable functioning of the Australian financial system. The Bank is currently engaged in projects to renovate and strengthen its banking and settlement capabilities and introduce new infrastructure to support real-time payments by households and businesses on a 24/7 basis. This will enable the Bank to continue to meet the banking and payment needs of its government and agency customers and, in turn, the Australian public.

Banking

The Reserve Bank's banking services comprise two broad components: core and transactional banking services. Both are provided with the objective of delivering secure and efficient arrangements to meet the banking and payment needs of the Australian Government and its agencies. In addition, the Bank provides banking and registry services to a number of overseas central banks and official institutions.

Core banking services are provided to the Department of Finance and the Australian Office of Financial Management (AOFM). These services derive directly from the Reserve Bank's role as Australia's central bank and require the Bank to manage the consolidation of Australian Government agency account balances – irrespective of which financial institution each agency banks with – into the government's Official Public Account (OPA) at the Bank on a daily basis. This involves 'sweeping' balances from agency accounts at transactional banks at the end of each business day and returning only those balances required to meet agencies' day-to-day payment obligations the following morning. Any receipts collected by an agency on behalf of the Commonwealth are retained in the OPA. During 2016/17, the Bank assisted the Department of Finance to ensure financial institutions meet the Commonwealth's consolidation requirements, including the transfer of receipts to the OPA and in the required timeframes.

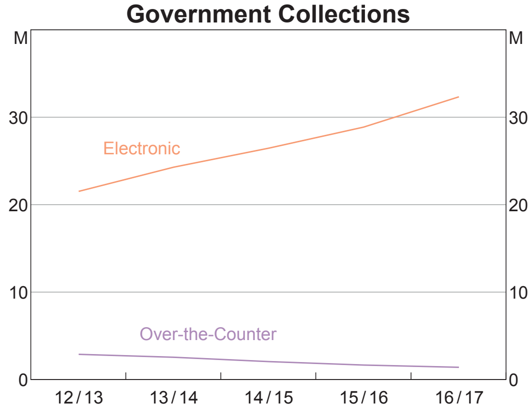
The Reserve Bank also provides the government with a term deposit facility for investment of its excess cash reserves, as well as a limited short-term overdraft facility to cater for occasions when there is unexpected demand for government cash balances. The overdraft facility was not accessed during 2016/17.

While the Reserve Bank manages the consolidation of the government's accounts, the AOFM has responsibility for ensuring there are sufficient cash balances in the OPA to meet the government's day-to-day spending commitments and for investing excess funds in approved investments, including term deposits with the Bank.

The Reserve Bank's transactional banking services are associated with more traditional banking and payment-related activities. Principal among these are services for making payments from government agencies to recipients' accounts. The Bank processed around 322 million domestic and 1.1 million international payments, totalling $517 billion and $10.8 billion respectively, for government agencies in 2016/17. Most of these were for the Department of Human Services and were made via direct entry. The Australian Government also makes payments by the real-time gross settlement (RTGS) system, cheque, BPAY and prepaid cards. Cheque volumes halved this year following Medicare's decision to stop offering cheques as a payment option and now comprise less than 1 per cent of agency payments. Over recent years, agencies' use of cheques has been declining more rapidly than that of the wider community, with agency cheques now making up 3 per cent of total cheques drawn compared with 5 per cent five years ago.

In addition to payments, the Reserve Bank provides government agency customers such as the Australian Tax Office with access to a number of services through which they can collect monies owed from both domestic and international payers. These include direct entry, RTGS, BPAY, cheque, eftpos, cash and card-based

The Bank processed
322 million
domestic payments
totalling
$517 billion
for government
agencies in 2016/17



services via the internet and phone. The Reserve Bank processed 34 million collections-related transactions for the Australian Government in 2016/17, amounting to $468 billion. Reflecting industry trends, over-the-counter cash and cheque collections have declined significantly over the past five years. Agencies are also actively encouraging customers to use lower cost electronic payment options, in particular those that are more likely to be delivered error free and so avoid the need for costly back-office reconciliation.

The provision of transactional banking services is consistent with the Reserve Bank's responsibilities under the *Reserve Bank Act 1959*, which requires the Bank to provide these services to the Australian Government if so required. A key difference between the Bank's core and transactional banking services is that the latter are offered in line with the Australian Government's competitive neutrality guidelines. To deliver the services, the Bank competes with commercial financial institutions, in many instances bidding for business at tenders conducted by the agencies themselves. The Bank must also cost and price the services separately from its other activities, including core banking services, and meet a prescribed minimum rate of return. Some 90 government agencies are transactional banking customers of the Bank.

Pro forma business accounts for transactional banking are provided on page 125 of this report.

The Reserve Bank works closely with its transactional banking customers, the Australian Government and the payments industry more broadly to ensure that its customers have access to services that meet their needs and those of the public. For some services, the Bank combines its specialist knowledge of the government sector with specific services and products from commercial providers to meet the government's banking needs. In 2016/17, the Bank made enhancements to its prepaid card product and explored new options for collecting monies owed from international payers. The Bank will continue to make use of combined service arrangements with commercial providers as the government's banking needs evolve.

Photo: *Australian Financial Review*

Former Assistant Governor (Financial System) Malcolm Edey addresses the *Australian Financial Review* Retail Summit, September 2016

Registry services are also provided by the Reserve Bank to supranational organisations issuing Australian dollar-denominated securities. Eight organisations currently use these services, with this number remaining relatively steady over recent years.

In common with other financial institutions, the Reserve Bank has been undertaking a significant program of work to upgrade its banking systems, moving them to a more modern programming language and architecture, and re-engineering a number of related business processes. Further milestones in the program were achieved during 2016/17. In particular, an upgraded capability was implemented in May 2017 to process revenue collected on behalf of government agency customers, and the first of two releases was completed in November 2016 to enable processing of direct entry payments through the new banking system. The Bank also engaged a third-party provider to upgrade the Bank's system for maintaining customers' accounts. The extensive process to select a suitable provider reflected the importance of the customer account maintenance system to the Bank's banking service. Allowing for the extended process, the system is scheduled to be operational in 2019.

During 2016/17, the Reserve Bank also continued its contribution to developing the payments industry's New Payments Platform (NPP), which will enable payments to be exchanged on a 24/7 basis in near real time together with more complete remittance information. As part of this contribution, work is under way to build, test and implement a system to process government-related transactions across the new platform. The Bank expects to make NPP services available to its agency customers from the payments industry's scheduled start of operations around the end of 2017. The Bank is working closely with government agencies to ensure they can take full advantage of the new payment capabilities over the medium term. Further information on the NPP is available below in the section on Settlement Services.

After-tax earnings from the Reserve Bank's transactional banking services were \$3.4 million in 2016/17, \$2.6 million lower than in the previous year. The fall was due largely to higher costs associated with systems development and service improvements. This was tempered slightly by increased revenue from transactions through the Bank's online collection services.

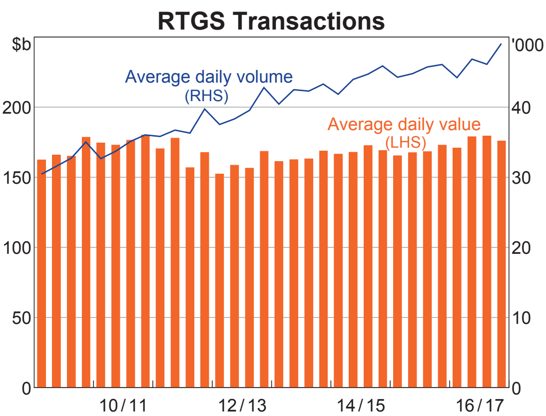
Settlement Services

The Reserve Bank owns and operates Australia's high-value settlement system – the Reserve Bank Information and Transfer System (RITS). RITS provides irrevocable settlement of high-value payment obligations across Exchange Settlement Accounts (ESAs) held at the Bank and is an integral part of Australia's financial system infrastructure. By providing a mechanism for RTGS, RITS eliminates the settlement risk that would otherwise arise between participants in high-value payments clearing and securities settlement systems. RITS also provides deferred net settlement services for low-value retail payments systems, equity settlements and settlement of property-related transactions.

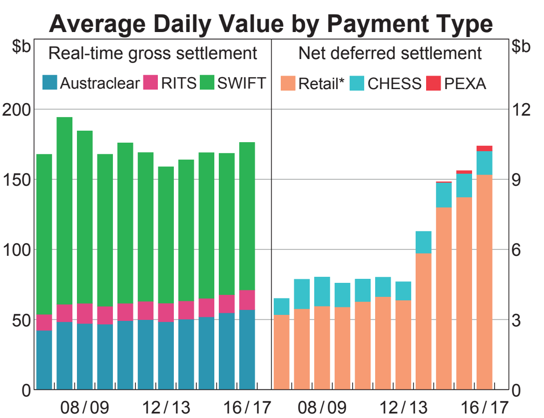
Banks and other authorised deposit-taking institutions with aggregate values of 0.25 per cent or more of RTGS settlements in RITS must use their own ESA to settle their obligations. ESAs are also mandatory for all Australian-licensed central counterparties that are determined to be systemically important by the Reserve Bank. Other institutions providing third-party payment services with a need to settle interbank obligations may also apply for an ESA.

At the end of 2016/17, 55 RITS members were using their own ESA to settle their payment obligations. Foreign bank subsidiaries and branches accounted for around two-thirds of these active ESA holders.

An additional 38 members held an ESA, but chose to use another ESA holder to settle their RTGS transactions. A further 71 institutions were members of RITS to be eligible to participate in the Reserve Bank's open market operations, but did not hold an ESA.



Source: RBA



* Cheques, cards and direct entry
Source: RBA

Transactions submitted to RITS are predominantly settled on an RTGS basis. RTGS is used for settling high-value customer, corporate and institutional payments, wholesale debt securities transactions and the Australian dollar leg of foreign exchange trades. On average, 47 000 RTGS transactions, worth $176 billion, were settled in RITS each day in 2016/17.

RITS is also used to settle payments on a deferred basis, after netting offsetting obligations between participants. Although net deferred settlement potentially involves some settlement risk, it allows for more efficient use of liquidity for high-volume and low-value payment types. Net deferred settlement occurs for retail payments (cheque, card, and direct entry) and some asset transactions (equities and some property-related transactions).

Settlement obligations arising from retail payments via cheque and some cards are settled the next business day in RITS at around 9.00 am. Settlement obligations from domestic MasterCard transactions are usually settled shortly after 7.30 am the next business day. Most settlement obligations arising from direct entry payments settle on a multilateral net basis at one of five designated settlement times on the day of exchange. During 2016/17, the aggregate average daily value of these retail payments settlements was $9.2 billion.

RITS also completes the interbank settlement of some asset-related transactions on a net deferred basis. The Clearing House Electronic Sub-register System (CHESS) batch, which provides for the

On average, 47 000 RTGS transactions, worth $176 billion, were settled in RITS each day

daily settlement of payments arising from equity market transactions, averaged $1.0 billion per day in 2016/17. PEXA batches, which settle interbank obligations arising from electronic property transactions processed by Property Exchange Australia Limited, averaged $210 million per day in 2016/17.

The introduction of the NPP in 2017/18 will represent a major addition to Australia's payments system infrastructure. The NPP is designed to meet several strategic objectives for the Australian payments system, including: enabling users to make real-time retail payments; allowing more complete remittance information to be sent with payments; providing the ability to make payments in a relatively simple way; and facilitating sending and receiving payments outside normal business hours. It is an important collaborative effort by the payments industry, supported by the Reserve Bank, to allow financial institutions to send and receive timely payments on a 24/7 basis.

The Reserve Bank has developed the RITS Fast Settlement Service (FSS) to settle NPP payments individually in real time across ESAs. This will enable financial institutions to provide customers with immediate funds availability without incurring credit risk. The FSS has been designed for high performance and availability, and its launch will mark a significant milestone for the Australian payments industry. As with RITS, the Bank will seek to recover its costs of operating the FSS over time from transaction fees.

RITS is a systemically important part of the Australian financial system and, as such, is designed to be a highly resilient system, with critical infrastructure duplicated in two geographically separate sites. RITS is regularly benchmarked against international standards, including an annual assessment by the Reserve Bank against the *Principles for Financial Market Infrastructures* (PFMI) set by the Committee on Payments and Market Infrastructures (CPMI)

The introduction of the NPP in 2017/18 will represent a major addition to Australia's payments system infrastructure

and the International Organization of Securities Commissions (IOSCO). The May 2017 PFMI assessment concluded that RITS adhered to all the relevant principles, and recognised the Bank's work to address recommendations following the previous assessment. This work included the implementation of additional processes to detect, prevent and, if necessary, recover from operational incidents including cyber-related incidents. Cyber-risk management arrangements for RITS have also been reviewed in light of guidance on cyber resilience issued by the CPMI and IOSCO in June 2016.

The Reserve Bank offers accounts to other central banks and official institutions overseas to allow for settlement of certain Australian dollar payments, and provides safe custody services to these overseas agencies. The face value of securities held in custody by the Bank in this capacity was around $73 billion at the end of 2016/17. The Bank also provides settlement services for banknote lodgements and withdrawals by commercial banks.

Banknotes

The Reserve Bank is responsible for producing and issuing Australia's banknotes. The Bank seeks to ensure the high quality of banknotes in circulation to maintain confidence in banknotes as a payment mechanism and a store of value. The Bank also conducts research and development to ensure that Australian banknotes remain secure against counterfeiting. To this end, the Bank is issuing an upgraded series of banknotes, with the first denomination – the $5 – issued in September 2016 and the $10 to be released in September 2017. At the end of June 2017 there were 1.5 billion banknotes, worth $73.6 billion, in circulation.

The Reserve Bank is responsible for producing and issuing Australia's banknotes. Public demand for banknotes stems from the role of banknotes as both a payment mechanism and a store of value. To preserve public confidence in the capacity of banknotes to perform these roles, the Bank:

- works with its wholly owned subsidiary, Note Printing Australia Limited (NPA), to design Australia's banknotes; arranges for their production through NPA; and issues the banknotes to meet public demand
- maintains the quality of banknotes in circulation by withdrawing old, worn banknotes and replacing them with new banknotes
- conducts research and development to ensure that Australian banknotes remain secure against counterfeiting.

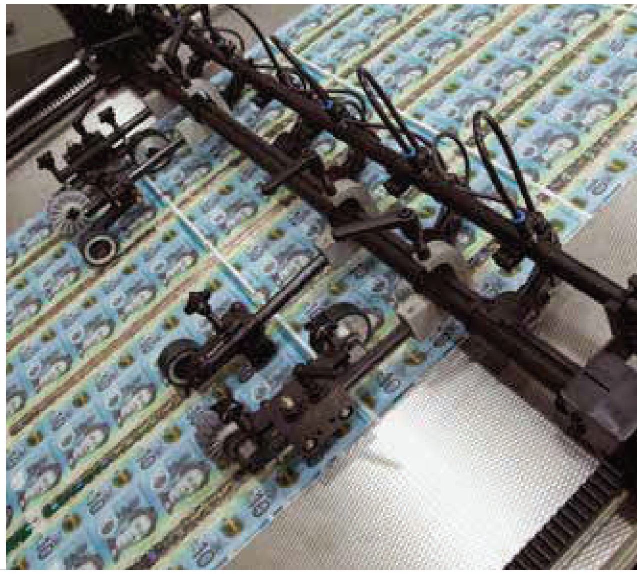
Next Generation Banknote Program

The Next Generation Banknote program was established in 2007 to ensure Australia's banknotes continue to be secure against counterfeiting. It will result in an upgraded series of banknotes with a range of innovative security features that have not previously been used on Australian banknotes.

The release of the upgraded series is occurring over a number of years. The first denomination in the new series, the $5 banknote, was issued from 1 September 2016. The design of the new $10 banknote was revealed in February 2017 and it will enter circulation from 20 September 2017. This will be followed by the $50, which is expected to enter circulation in late 2018. The remaining denominations will be introduced in subsequent years.

The new banknotes will retain many of the key design elements of the current banknote series, including the people portrayed, their size and their colour palette. There are, however, design changes that have been made to accommodate the new security features. The new banknotes include a top-to-bottom clear window and each displays a different species of Australian wattle and native bird within a number of the security features.

An integral element of the new banknote program has been the Reserve Bank's consultation with key stakeholders to ensure that



(Left) Governor Philip Lowe providing samples of his signature for the new $10 banknote; (top right) The new $10 banknote has microprint in multiple locations, including excerpts from AB 'Banjo' Paterson's and Dame Mary Gilmore's poetry; (bottom right) The new $10 banknote in production ahead of entering general circulation on 20 September 2017

The new $10 banknote will enter circulation from 20 September 2017

the new banknotes continue to meet the needs of the community. This includes supporting the broader banknote industry and high volume cash handlers during the transition to the new banknote series. The Bank continues to engage with manufacturers, deployers and owners of banknote processing equipment, and provides them with access to test material to develop and confirm equipment solutions well ahead of the new banknotes being issued. The Bank has a communication strategy to ensure that the public is well informed about the new banknotes and can readily identify the new security features.

For the $5 banknote, this included an extensive advertising campaign in regional newspapers and television, as well as on radio and online, with material also translated into other languages. A promotional video that illustrates the dynamic nature of the new security features has been viewed more than 1 million times.

As part of the Reserve Bank's public awareness campaign, the Bank launched a mobile app, 'RBA Banknotes'. The app provides an interactive tool that enables users to learn about banknote design and security features on all current Australian banknotes, including the new $5 and $10, as well as how to handle counterfeit and damaged banknotes.

The time and cost of the Next Generation Banknote program is budgeted at $37 million for all five denominations. To date, $29.8 million of this has been spent on the process of designing and testing the new banknote series, as well as the extensive community consultation, communication and education initiatives.

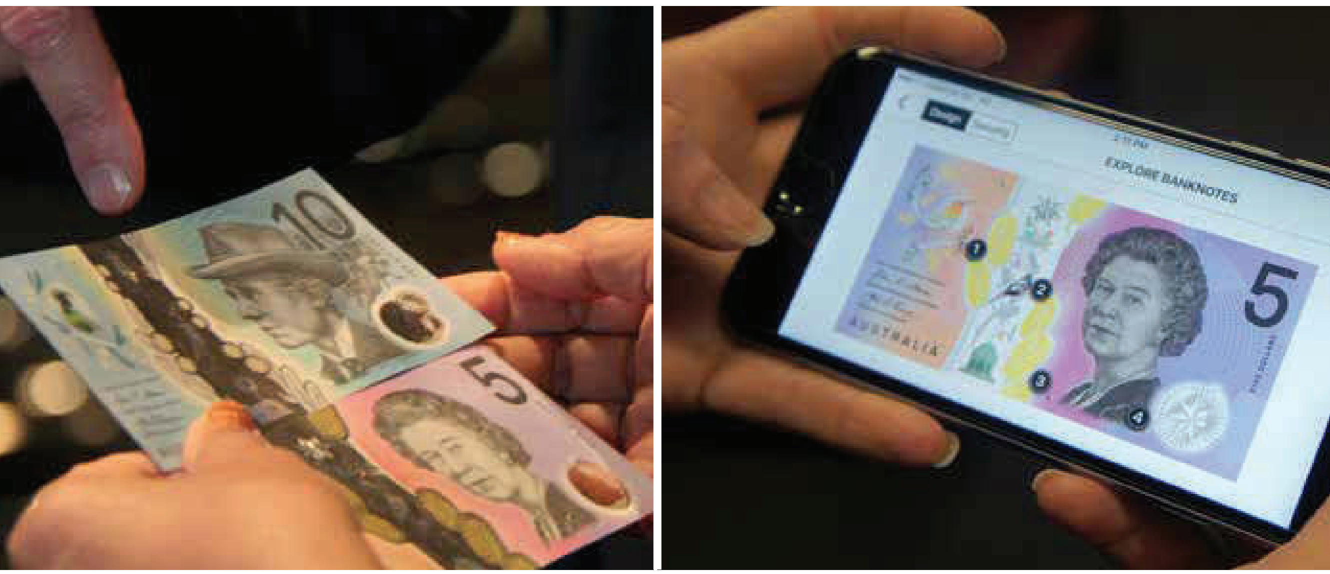
Banknote Accessibility

From the outset of the current program to upgrade the banknotes, it was decided that the existing accessibility characteristics of Australia's banknotes – their size differentials, vibrant colours and bold, contrasting numerals – would be retained to ensure that Australia's banknotes are accessible for people with impaired vision.

The new series of banknotes also includes a tactile feature, which was developed in consultation with the vision-impaired community to provide a feature directly on the banknote that is durable, simple and readily usable. The new $5 banknote has a raised bump on each of its long edges next to the top-to-bottom window. Subsequent denominations will have increasing numbers of raised bumps in a similar location.

Community Liaison

The Reserve Bank actively engages with a range of interested parties, including users



(Left) Banknote equipment manufacturers attended presentations where they could see the new banknote designs before they were publicly released, and were given access to test material; (right) The RBA Banknotes app was launched to coincide with the release of the $5 banknote and manufacturers of banknote equipment, law enforcement agencies, retail organisations, schools and financial institutions, with the aim to increase community knowledge about banknotes. More than 145 banknote-related presentations were given by Bank staff during 2016/17. The majority of these presentations were delivered to visitors to the Reserve Bank of Australia Museum.

As noted above, the Reserve Bank has continued to provide information about the new banknote series to the public in a variety of ways. One area of focus has been retailers and commercial banks to ensure that their staff are trained and ready for customer enquiries. Bank staff have attended a number of industry events and delivered presentations to high-volume cash handling groups to share information about how to use the security features of the new banknotes.

Banknote Infrastructure Modernisation Program

In preparation for the logistical demands arising from the introduction of the new banknote series, the Reserve Bank is well advanced in a program to upgrade its existing banknote infrastructure. The main objectives of the upgrade are to increase banknote storage and processing capacity, and to introduce new technologies and systems to improve banknote logistics processes and simplify distribution arrangements.

The upgrade involves construction of the National Banknote Site (NBS) in Craigieburn, Victoria. Construction of the new two-storey building was completed in early 2017 and, following the commissioning of the automatic processes, it is scheduled to be fully operational by early 2018.

Banknote Research and Development

The Reserve Bank maintains an active research and development (R&D) program focused on the development of innovative security features and detection technologies for Australian banknotes. The primary aim of this program is to ensure that Australian banknotes remain highly secure against counterfeiting and easy to authenticate for a wide variety of users. A core function of the R&D program is research into new and emerging technologies that can be developed into future generations of security features and detection equipment for banknotes. This is achieved in part through collaboration with domestic and international experts from various external organisations, including universities, public and private companies, research institutes and other central banks. Fundamental to this program is a continuing assessment of the vulnerability of banknotes to different forms of counterfeiting, the mechanisms by which banknotes wear in circulation, and how the public and banknote processing machines use and authenticate banknotes.

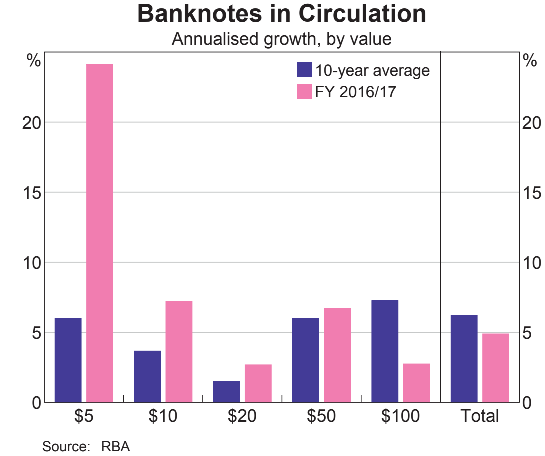
In addition to these activities, the Reserve Bank contributes to several international forums associated with various aspects of banknote security. These include: the Central Bank

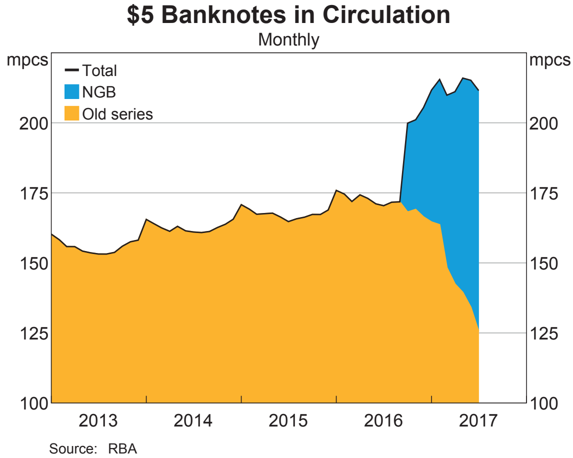
More than 145 banknote-related presentations were given by Bank staff during 2016/17

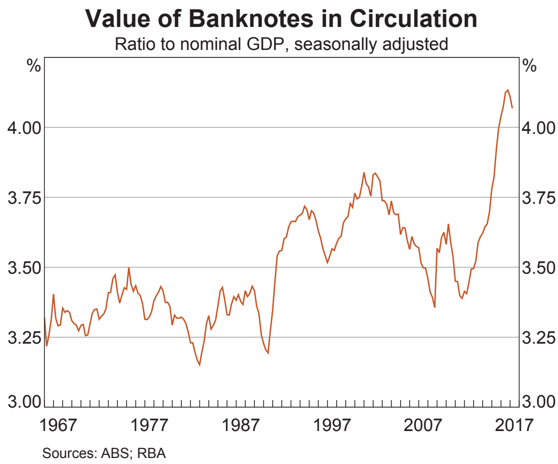
(Top) Visitors crowded the Head Office Banking Chamber on 1 September 2016 to be among the first to receive the new $5 banknote; (above) then Assistant Governor (Business Services) Michele Bullock (now Assistant Governor (Financial System)) interviewed on ABC television for the launch of the new $5 banknote, September 2016

Counterfeit Deterrence Group, which examines emerging threats in counterfeiting technologies; the Reproduction Research Centre, which provides facilities to test new security features; and the Four Nations Counterfeit Deterrence Working Group, which is a group of central banks that collaborate on the development of technologies to reduce counterfeiting threats. The Bank also works closely with its partners and suppliers to incorporate new technologies and features into the banknote production process.

In 2016/17, the research program continued to focus on providing technical advice and expertise as part of the development of the new series of Australian banknotes by conducting trials, assessing new technologies and strategies to ensure the durability of the new security features, and developing instrumentation for banknote examination. This was done in conjunction with the development of new testing methodologies that will form part of the Reserve Bank's ongoing quality assurance program.







Banknotes on Issue

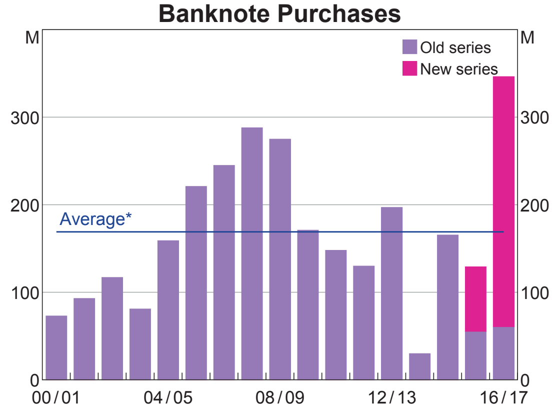
The value of banknotes in circulation increased by 5 per cent in 2016/17, slightly below its long-term average growth rate of 6 per cent, reflecting below-average growth in the $100 denomination. By contrast, the value of low-denomination banknotes increased relatively strongly, particularly in the case of the $5 banknote, but these account for only 1.4 per cent of the value of banknotes in circulation. At the end of June 2017, there were 1.5 billion banknotes, worth $73.6 billion, or around 4 per cent of nominal GDP, in circulation. The ratio of the value of banknotes in circulation to nominal GDP remains at an historically high level.

The marked increase in the number of $5 banknotes in circulation over 2016/17 was a result of the release of the new $5 banknote in September 2016. As at the end of June 2017, 86.5 million new $5 banknotes had been issued by the Reserve Bank while only 46.7 million banknotes from the previous series had been returned.

Distribution

The Reserve Bank maintains banknote holdings to accommodate growth in the number of banknotes in circulation, for seasonal fluctuations in demand and for contingency purposes in

At the end of June 2017, there were 1.5 billion banknotes, worth $73.6 billion, in circulation



* Average banknote purchases over displayed time period
Source: RBA

the event of systemic shocks and production disruptions. The Bank has established distribution agreements with a number of commercial banks, which provide the banks with access to banknotes. The Bank issued banknotes worth $9.0 billion in 2016/17, of which $3.6 billion had been in circulation previously and $5.4 billion were new.

The Reserve Bank aims to maintain a high quality of banknotes in circulation to ensure public confidence in their suitability as a payment mechanism and store of value. High-quality banknotes are more readily handled by machines and make it more difficult for counterfeits to be passed. For this reason, the Bank has arrangements that encourage the commercial banks and the cash-in-transit companies to continue to distribute banknotes that remain fit for circulation and return those that are unfit to the Bank's processing site in Craigieburn. These unfit (damaged) banknotes are assessed using high-speed processing machines to confirm their authenticity and quality. In 2016/17, the Bank received $2.0 billion worth of banknotes, of which $1.9 billion worth was deemed to be unfit for recirculation.

The Reserve Bank also provides an additional service through its Damaged Banknotes Facility. The facility is offered to members of the public who have unwittingly come into possession of damaged banknotes or whose banknotes are accidentally damaged, with the aim to ensure that they do not face financial hardship. Claims that meet the requirements set out in the Bank's Damaged Banknotes Policy are paid based on their assessed value. The Bank processed 15 378 claims and made $5.3 million in payments in 2016/17.

Counterfeiting Rates

Australia's level of counterfeiting remains low by international standards. In 2016/17, around 25 500 counterfeits, with a nominal value of nearly $1.5 million, were detected in circulation. This corresponds to around 17 counterfeits detected per million genuine banknotes in circulation, a 26 per cent reduction from 2015/16.

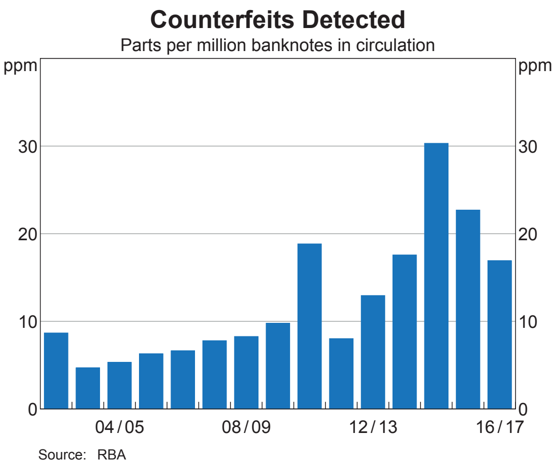
To combat counterfeiting in Australia, the Reserve Bank works closely with law enforcement agencies in Australia and overseas to monitor trends and identify emerging threats. As part of this arrangement, the Bank provides analytical

Counterfeit Banknotes in Australia(a)
2016/17

	$5	$10	$20	$50	$100	Total
Number	29	91	320	20 749	4 302	25 491
Nominal value ($)	145	910	6 400	1 037 450	430 200	1 475 105
Parts per million	0.1	0.7	1.9	30.8	12.8	16.9

(a) Figures are preliminary and subject to upward revision due to lags in counterfeit submissions to the Reserve Bank
Source: RBA

Australia's level of counterfeiting remains low by international standards



and counterfeit examination services and prepares expert witness statements and court testimonies to assist the agencies with their investigations.

In 2016/17, the Australian Federal Police made a number of arrests, including one in connection with a major source of counterfeit banknotes. During the year, the Commonwealth Department of Public Prosecutions prosecuted 27 matters involving possession, uttering and making of counterfeit currency.

Note Printing Australia Limited (NPA)

NPA is a wholly owned subsidiary of the Reserve Bank that produces banknotes and supplies other related services to the Bank and some other entities. In 2016/17, NPA delivered 346 million Australian banknotes to the Bank, comprising 118 million new series \$5 banknotes, 168 million new series \$10 banknotes and 60 million existing series \$100 banknotes. This compared with 129 million Australian banknotes delivered to the Bank by NPA in 2015/16. NPA also provided banknote distribution and banknote processing services to the Bank until 16 February 2017, when the Bank resumed responsibility for the processing operations. The aggregate amount paid by the Bank to NPA in 2016/17 for the supply of banknotes and related services was \$99.9 million.

In addition, NPA delivered 107.5 million banknotes under contract to Singapore, Papua New Guinea and Brunei in 2016/17, dealing directly with the respective central banks in those countries. NPA also produced 1.9 million P- series passports for Australia's Department of Foreign Affairs and Trade.

In 2016/17, NPA delivered 346 million Australian banknotes to the Reserve Bank

International Financial Cooperation

The Reserve Bank continues to participate actively in initiatives that seek to address the challenges facing the global economy and improve the global financial architecture. It does so through its membership of global and regional forums and its close bilateral relationships with other central banks.

Group of Twenty (G20)

Purpose

The G20 facilitates international cooperation on economic and financial policy issues.

Reserve Bank Involvement

The Reserve Bank participates in meetings of the G20 covering issues such as developments in the global economy and financial regulation. The Reserve Bank is represented at high-level meetings by the Governor and Assistant Governor (Economic), while other senior staff participate in G20 working groups and contribute to the G20's financial regulation reform agenda.

The G20 presidency was held by China from December 2015 to November 2016. In December 2016, the G20 presidency rotated to Germany. A key theme of the German presidency in 2017 was resilience. In this regard, the G20 Framework (for Strong, Sustainable, Balanced and Inclusive Growth) Working Group agreed on a set of non-binding principles to enhance economic resilience. G20 members also continued to update their comprehensive growth strategies, outlining policies that G20 members are undertaking to increase GDP. In 2017, members were encouraged to incorporate policies that enhance resilience (using the 'resilience principles') and promote inclusiveness.

The Reserve Bank's Involvement in the G20

In 2017, the G20 has remained committed to strengthening the international monetary system. In line with this objective, the G20 International Financial Architecture Working Group reiterated its support for maintaining the International Monetary Fund (IMF) as a strong institution with adequate resources, and discussed further enhancing the IMF's lending 'toolkit'. Members of the G20 considered a range of other ways to increase the resilience of the international monetary system, including by enhancing the monitoring and management of risks associated with capital flows, improving sovereign debt sustainability and strengthening the global financial safety net. This year, there was some emphasis on encouraging multilateral development banks to mobilise private sector finance for infrastructure investment.

Financial regulation reform, both to address the problems revealed by the global financial crisis as well as to mitigate new and emerging risks, remains a continuing priority of the G20. In this context, over recent years the G20 and the Financial Stability Board (FSB) have focused on several core areas for financial regulation reform, in particular:

- building resilient financial institutions, especially the Basel III reforms
- ending 'too big to fail'
- addressing 'shadow banking' risks
- making derivatives markets safer.

As many of the core post-crisis policy reforms have been implemented, or are in the process of being adopted, there is an increasing focus on assessing their effectiveness. Accordingly, the FSB, at the request of the G20, developed a framework for the post-implementation evaluation of the G20 financial regulatory reforms. The framework aims to guide assessments of whether the G20 core financial reforms are achieving their intended outcomes, and to help identify any material unintended consequences that may have to be addressed.

Financial Stability Board (FSB)

Purpose

The FSB promotes international financial stability by coordinating national financial sector authorities and international standard-setting bodies as they work towards developing strong regulatory, supervisory and other financial sector policies.

FSB members include representatives from 24 economies as well as the main international financial institutions – including the Bank for International Settlements (BIS) and the IMF – and standard-setting bodies, such as the Basel Committee on Banking Supervision (BCBS).

Reserve Bank Involvement

The Governor is a member of the FSB Plenary (the main decision-making body of the FSB), the Steering Committee and the Standing Committee on Assessment of Vulnerabilities (SCAV). The Governor is also co-Chair of the Regional Consultative Group (RCG) for Asia, taking up a two-year appointment in July 2017.

Senior staff members of Financial Stability Department participate in meetings of the:

- Analytical Group on Vulnerabilities (AGV), which supports the work of the SCAV
- Resolution Steering Group (ReSG)
- Financial Innovation Network (FIN).

A number of other staff members have participated, or continue to participate, in several FSB working groups.

As has been the case since the financial crisis, the FSB has continued to play a key role in progressing the global financial regulatory reform agenda.[1] The FSB's agenda includes monitoring the implementation of the post-crisis reforms in the areas noted above, as well as assessing new and evolving risks, and potential regulatory responses. The FSB conducts this work mainly through several committees, with overall direction provided by the FSB Plenary.

The Governor and senior executives from the Reserve Bank and other Council of Financial Regulators (CFR) agencies are members of the main FSB bodies.[2]

The SCAV is the main FSB body for identifying and assessing risks in the global financial system. Supporting the SCAV is the AGV, with the FIN providing input to both groups in the area of financial innovation, in order to assess its potential as a source of systemic risk. Risks associated with financial technology ('fintech'), including cyber risks, remain a focus of the SCAV. Fintech and the spread of digital technology more generally were themes of the German G20 presidency. The Australian Treasury, in liaison with the Reserve Bank and the Australian Securities and Investments Commission (ASIC), contributed to a new FSB body, which examined the financial stability issues related to fintech. Its report was presented to the G20 Summit in early July 2017.

The SCAV has also been considering structural vulnerabilities posed by asset management activities. In January 2017, the FSB published its final policy recommendations to address vulnerabilities in the sector. The work on asset management is linked to ongoing post-crisis efforts by the G20/FSB to address the risks posed by 'shadow banking'. The Reserve Bank continues to be directly involved in the FSB's work on shadow banking through membership of the Shadow Banking Experts Group. This group coordinates the collection and review of shadow banking data, as part of the FSB's annual global shadow banking monitoring exercise.

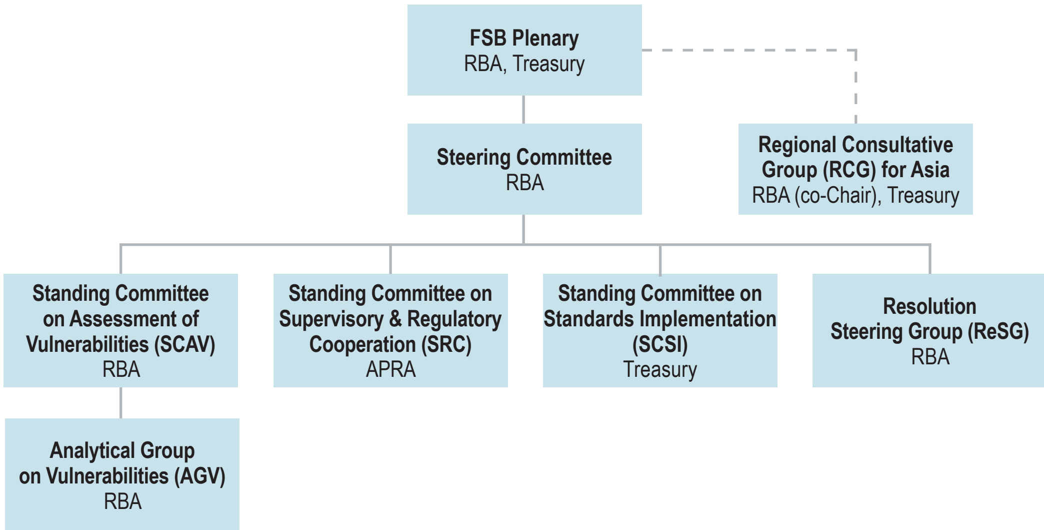
In addition, Reserve Bank staff members have been involved in other key FSB work areas over the past year, including:

- assessing the effectiveness of recent financial regulatory reforms. A Deputy Head of Financial Stability Department chaired one of the two working groups that developed a framework to evaluate the effects of the G20 financial regulatory reforms. The framework was presented to the G20 Summit in July 2017
- contributing to the FSB's peer review process. FSB members have committed to strengthening their adherence to international standards. To do this, the FSB conducts a regular program of country and thematic peer reviews of its member jurisdictions. During the year under review, a staff member from Financial Stability Department joined a country peer review of South Korea. The peer review report is due to be published later in 2017
- meetings of the FSB's ReSG, which is progressing the FSB's work on resolution in line with its *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the *Key Attributes*). The ReSG has worked on several specific areas during the year in review, including enhancing central counterparty (CCP) resolvability (see below), internal total loss-absorbing capacity, and the continuity of access to financial market infrastructures (FMIs) by a firm in resolution
- meetings of the Cross-border Crisis Management Group for Financial Market Infrastructures, a ReSG subgroup, which is working on resolution regimes for CCPs.

1 Further detail on FSB activities is reported in the RBA's semiannual *Financial Stability Review*.

2 The CFR is a non-statutory coordinating body for Australia's main financial regulatory agencies, namely the Reserve Bank (which chairs the CFR), the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission and the Australian Treasury.

The Reserve Bank and CFR Involvement in Key FSB Committees



Arising from this group's work, the FSB published guidance on CCP resolution and resolution planning in July 2017. This guidance complements the FSB's *Key Attributes*, and is intended to assist authorities in their resolution planning and to promote international consistency

- participating in meetings of the RCG for Asia, one of six regional groups established to expand the FSB's outreach activities with non-member economies and to discuss issues relevant for the region.

Bank for International Settlements (BIS)

Purpose

The BIS and its associated committees play an important role in supporting collaboration among central banks and other financial regulatory bodies. They do so by bringing together officials to exchange information and views about the global economy, vulnerabilities in the global financial system and other issues affecting the operations of central banks.

Reserve Bank Involvement

The Reserve Bank is one of 60 central banks holding shares in the BIS.

The Governor or Deputy Governor attends the bimonthly meetings of governors and participates in meetings of the Asian Consultative Council.

The Deputy Governor chaired the Markets Committee (MC) until January 2017 and was also chair of the Foreign Exchange Working Group (FXWG), which was established under the auspices of the MC.

The Assistant Governor (Financial Markets) is a member of the MC and the Committee on the Global Financial System (CGFS).

The MC considers how economic and other developments, including regulatory reform and technological change, may affect market functioning, particularly central bank operations. In the past year, topics of discussion have included: developments in major financial markets, including in China; the implications of extremely accommodative monetary policy in many economies for market functioning and the transmission of monetary policy; technological change and monetary policy implementation; the changing structure of foreign exchange markets; and approaches taken by central banks to gathering market intelligence. The CGFS also monitors developments in financial markets, but focuses on identifying and assessing potential sources of stress in the global financial system.

The FXWG released the Global Code of Conduct for the Foreign Exchange Market in May 2017, together with principles and mechanisms for fostering adherence to the Code. The first phase of the Code had been published in May 2016. The Code was developed in partnership with a private sector Market Participants Group and establishes a common set of guidelines for good practice in the foreign exchange market. In addition to the Deputy Governor chairing the Group, a Deputy Head of International Department made a significant contribution to the work of the FXWG. The Code will be maintained by a new Global Foreign Exchange Committee, comprising public and private sector representatives from the foreign exchange committees of 16 trading centres, including the Australian Foreign Exchange Committee (which is chaired by the Deputy Governor).

In the past year, Reserve Bank staff have participated in a number of other MC and CGFS working groups, including:

- a CGFS study group on the nexus between objective-setting and communication of monetary and macroprudential policies, which published its final report in November 2016
- a CGFS study group on repo market functioning, which published its final report in April 2017
- a CGFS working group on liquidity assistance, which published its final report in April 2017.

A Reserve Bank staff member also contributed to an MC paper on Market Intelligence Gathering at Central Banks, which was published in December 2016.

Basel Committee on Banking Supervision (BCBS)

Purpose

The BCBS is hosted by the BIS, and is the international standard-setting body for the banking sector. It provides a forum for regular cooperation on banking supervisory matters among its 28 member jurisdictions. It seeks to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.

Reserve Bank Involvement

The Governor is a member of the Group of Governors and Heads of Supervision (GHOS), which is the oversight body for the BCBS.

The Assistant Governor (Financial System) is a member of the BCBS.

A Deputy Head of Financial Stability Department is a member of the Macroprudential Supervision Group (MPG), which monitors and reports to the BCBS on systemic risk and global developments that relate to macroprudential and systemically important banks' supervision policy.

Upon appointment to their current positions, the Governor and Assistant Governor (Financial System) became members of GHOS and the BCBS, respectively. In addition to ongoing enhancements to its supervisory standards, a recent focus of the BCBS has been the finalisation of outstanding Basel III capital reforms, which aim to reduce the observed variability in banks' risk-weighted assets. During the year in review, discussions continued at the BCBS on reaching a final agreement, with the Bank and the Australian Prudential Regulation Authority (APRA), as BCBS members, contributing. The BCBS also continues to monitor the implementation of the Basel III capital and liquidity standards for banks and regularly reports its findings to both the FSB and the G20. In its April 2017 progress report, the BCBS reported that all member jurisdictions had implemented risk-based capital rules, liquidity coverage ratio regulations and capital conservation buffers. Domestically, APRA continues to implement BCBS standards in line with internationally agreed timetables.

Over the past year, the MPG has worked on the BCBS's methodology for identifying global systemically important banks (G-SIBs), including the three-year review of the G-SIB framework. Proposals to revise the methodology arising from that review were released for consultation in March 2017. The MPG also continued discussion of issues related to the design and implementation of countercyclical capital buffer policies and the different policy approaches to managing systemic risk in the banking sector.

Committee on Payments and Market Infrastructures (CPMI)

Purpose

The CPMI is hosted by the BIS, and serves as a forum for central banks to monitor and analyse developments in payment, clearing and settlement infrastructures and sets standards for them. It has members from 24 jurisdictions.

Joint working groups of the CPMI and the International Organization of Securities Commissions (IOSCO) bring together members of these two bodies to coordinate policy work on the regulation and oversight of FMIs.

Reserve Bank Involvement

Senior staff members from Payments Policy Department are members of the CPMI, and have participated in the CPMI Working Group on Retail Payments and the CPMI Working Group on Digital Innovations.

Senior staff members from Payments Policy Department are also members of the CPMI-IOSCO Steering Group, CPMI-IOSCO Implementation Monitoring Standing Group (IMSG), and CPMI-IOSCO Policy Standing Group (PSG).

A senior staff member from Payments Policy Department contributed to a July 2017 CPMI-IOSCO report that set out further guidance on CCP resilience, including for approaches to stress testing and margining. This work is part of the CCP work plan developed in conjunction with the FSB and BCBS. Staff members from Payments Policy Department contributed to an implementation monitoring report for Hong Kong, as well as participated in the broader implementation monitoring work of CPMI-IOSCO. Senior staff members from Payments Policy Department also contributed to a CPMI report on faster retail payments, and a CPMI report on the use of distributed ledger technology in payment, clearing and settlement systems.

Cooperative Oversight Arrangements

Purpose

Several overseas-based FMIs hold Australian clearing and settlement facility licences, for which the Reserve Bank has certain regulatory responsibilities under the *Corporations Act 2001*. As well, a number of overseas-based payments systems play an important role in

Australia's financial system. The Reserve Bank participates in several multilateral and bilateral arrangements to support its oversight of these FMIs.

Reserve Bank Involvement

Staff from Payments Policy Department participated in:

- an arrangement led by the Federal Reserve Bank of New York to oversee CLS Bank International, which provides a settlement service for foreign exchange transactions
- a global oversight college and a crisis management group for LCH Limited, both chaired by the Bank of England
- an information-sharing arrangement with the US Commodity Futures Trading Commission, in relation to CME Inc.
- the Society for Worldwide Interbank Financial Telecommunication (SWIFT) Oversight Forum, chaired by the National Bank of Belgium.

International Monetary Fund (IMF)

Purpose

The IMF is mandated by its members to oversee the stability of the international monetary system. The IMF performs this role through: bilateral and multilateral surveillance, which involves monitoring, analysing and providing advice on the economic and financial policies of its 189 members and the linkages between them; and the provision of financial assistance to member countries experiencing actual or potential balance of payments problems.

Reserve Bank Involvement

Australia holds a 1.39 per cent quota share in the IMF and is part of the Asia and the Pacific Constituency. This constituency was represented on the IMF's Executive Board by an Executive Director from Australia until November 2016, and by an Executive Director from South Korea for the remainder of the 2016/17 financial year.

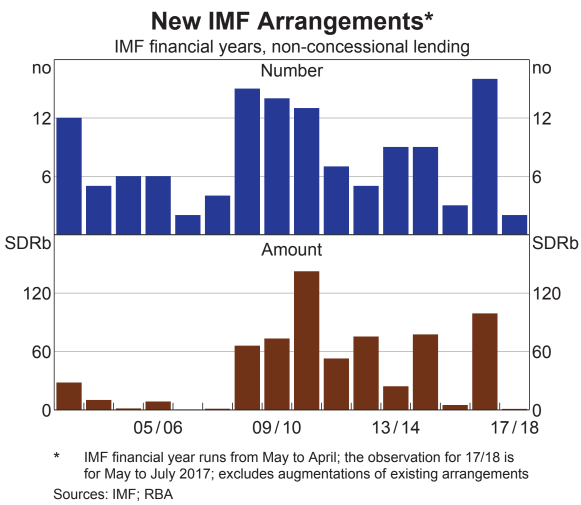
The Reserve Bank supports the Constituency Office at the IMF by seconding an advisor with expertise in financial markets and financial sector issues. The Bank also works with the Australian Treasury to provide support to the Constituency Office on issues that are to be discussed by the IMF's Executive Board.

The IMF has continued to provide financial assistance to member countries. During the IMF's 2016/17 financial year (which runs from May to April), the total value of new lending arrangements (excluding concessional facilities) rose to its highest level since 2010/11, supported by a large volume of new lending. There have been two new lending arrangements since the start of the IMF's 2017/18 financial year.

The pick-up in new lending during the IMF's 2016/17 financial year was accompanied by an increase in IMF credit outstanding, following declines over the previous four consecutive IMF financial years. At the end of July 2017, IMF non-concessional credit outstanding was 47 billion Special Drawing Rights (SDRs), 60 per cent of which was accounted for by Greece, Portugal and the Ukraine.

The Reserve Bank and other CFR agencies have commenced preparations for the next IMF Financial Sector Assessment Program (FSAP) review of Australia's financial system and regulatory framework, which is likely to take place in 2018. Australia's previous FSAP was in 2012.

Deputy Governor Guy Debelle (left, front) and Treasurer the Hon Scott Morrison MP (centre) at the International Monetary and Financial Committee Plenary, Washington DC, October 2016



Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)

Purpose

EMEAP brings together central banks from 11 economies in the east Asia-Pacific region – Australia, China, Hong Kong SAR, Indonesia, Japan, South Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand – to discuss issues relevant to monetary policy, financial markets, financial stability and payments systems in the region.

Reserve Bank Involvement

The Reserve Bank participates in EMEAP at a number of levels, including at the Governor and Deputy Governor levels.

Senior staff also participate in the EMEAP Working Groups on Financial Markets, Banking Supervision, and Payment and Settlement Systems, and in meetings of Information Technology (IT) Directors.

The EMEAP meetings consist of the Governors' and the Deputies' meetings, as well as the Monetary and Financial Stability Committee (MFSC) meeting. Support is provided by several working groups, which focus on a wide range of central banking issues. These groups also continued to maintain close relationships with international institutions, such as the IMF and the BIS, through regular dialogue on topical issues.

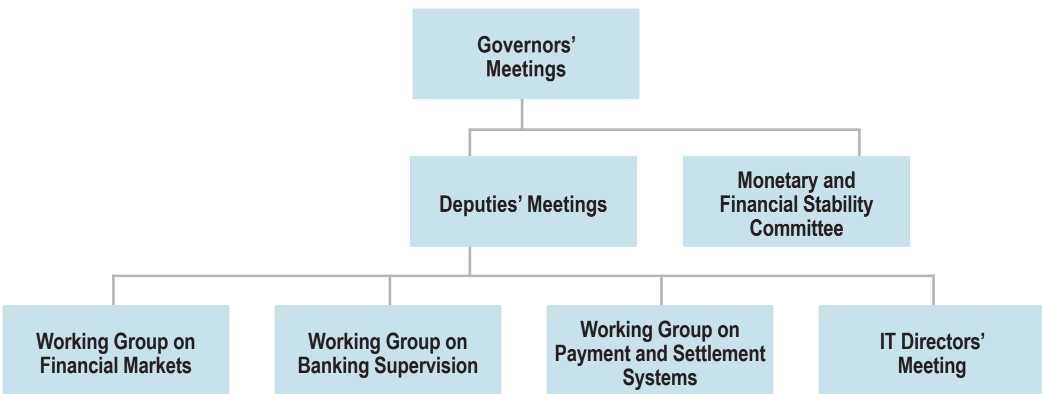
The Reserve Bank of New Zealand hosted the Governors' and Deputies' meetings during the year in review. Members discussed a range of topics at these meetings, such as the potential impact of global factors on monetary policy in EMEAP jurisdictions, as well as recent supply-side developments in EMEAP economies.

The MFSC provides an important forum for the discussion of current economic and financial market issues of direct relevance to EMEAP members. As current Committee Chair, the Reserve Bank has chaired two meetings of the MFSC in 2016/17. Developments in fintech have been an important focus of recent meetings given the potential risks and benefits for the financial system and implications for policy. These meetings also included representation from international institutions, such as the IMF and BIS, as a way of further facilitating regular discussions on conjunctural issues.

The Working Group on Financial Markets focuses on the analysis and development of foreign exchange, money and bond markets in the region. Every second meeting of this group is held in conjunction with the BIS Financial Markets Forum. In the year in review, the group continued to hold regular discussions on the impact of global policy developments and regulatory reform measures on regional financial markets. The group also continued its work on developing local currency bond markets, through the Asian Bond Fund (ABF) Initiative (see the chapter on 'Operations in Financial Markets' for details of the Reserve Bank's investments in the ABF). The recent focus has been on development of money markets and securities lending in Asia.

The Working Group on Banking Supervision (which also comprises representatives of EMEAP members' prudential regulators, including APRA)

The Reserve Bank's Involvement in EMEAP



Governor Philip Lowe (front, second from right) with participants at the 22nd EMEAP Governors' Meeting, Auckland, May 2017

provides a regional forum for sharing experiences about best practices in banking supervision. The group discussed several issues over the previous year, such as the Basel III and over-the-counter derivatives market reforms, and potential future issues in banking supervision.

The Working Group on Payment and Settlement Systems (WGPSS) is a forum for sharing experiences relating to the development, oversight and regulation of payment and settlement systems. The group focused on several issues over the year in review, including: the application of new technologies such as distributed ledger technology to payment and settlement systems; central bank initiatives to support fintech development; the development of fast retail payment systems; and cyber resilience and oversight of FMIs. A study group of the WGPSS is currently examining the development of payments-related fintech in the EMEAP region and the implications for central banks.

The IT Directors' Meeting provides a forum for discussions on developments in IT and their implications for central banks. Recent meetings have focused on data management, technology planning and system resilience.

Organisation for Economic Co-operation and Development (OECD)

Purpose

The OECD comprises the governments of 35 countries and is committed to promoting policies that improve economic and social development globally.

Reserve Bank Involvement

The Reserve Bank's Chief Representative in Europe participates in the OECD's Committee on Financial Markets and the Advisory Task Force on the OECD Codes of Liberalisation.

The OECD Committee on Financial Markets is responsible for financial market issues and aims to promote efficient, open, stable and sound financial systems. In the past year, the committee has held discussions with private sector experts on the implications of the digitalisation of finance and about market-based solutions to address the problem of high levels of non-performing loans on bank balance sheets in some countries. The committee has continued to review and contribute to OECD work on financial sector guarantees, long-term investment financing and green financing.

The Advisory Task Force on the Codes (ATFC) provides advice on policy measures introduced by adherents to the Codes of Liberalisation assessed against their obligations under the codes. It also contributes to the assessment of policy measures of countries that are applying for adherence with the codes. In the past year, the ATFC has focused on the implementation of a broad review of the code of capital movements.

Technical Cooperation and Engagement in the Asia-Pacific Region

The Government Partnership Fund (GPF)

Purpose

The Australian Government's GPF program has supported an exchange of skills and knowledge between Australian public sector institutions and their Indonesian counterparts through a series of attachments and workshops since 2005/06.

Reserve Bank Involvement

In 2016/17, a total of seven Bank Indonesia staff members were attached to the Reserve Bank, covering the areas of economic analysis, financial stability and auditing. These visits brought the total number of individual attachments since the start of the program to 197.

The Reserve Bank fosters close ties with South Pacific countries through participation in Governor-level meetings, staff exchanges and the provision of technical assistance across a wide range of central banking issues.

In December 2016, the Reserve Bank participated in the annual meeting of South Pacific Central Bank Governors held in Dili, Timor-Leste; the group has recently expanded to include the Central Bank of Timor-Leste. In addition to discussing recent economic developments in the region, there was considerable discussion of developments in remittance flows in the region and the use of technology to foster economic development. The Governors also met with the major regional commercial banks to discuss banking issues.

The Reserve Bank continued to provide financial support to an officer of the Bank of Papua New Guinea undertaking postgraduate studies at an Australian university in the area of economics, finance and computing. This Reserve Bank of Australia Graduate Scholarship was first awarded in 1992. The Bank also hosted short-term visits of officers from the Reserve Bank of Fiji and the Bank of Papua New Guinea.

Bilateral Relations and Cooperation

As in previous years, the Reserve Bank hosted a number of visitors from overseas, predominantly from foreign central banks. The visits covered the full range of the Bank's activities and included delegations from China, Indonesia, Lebanon, New Zealand, Papua New Guinea and the United States. The Bank also hosted a number of secondees from the Bank of Canada, the Bank of England and the Bank of Thailand. A number of Reserve Bank staff are currently seconded to other central banks and various international organisations, which facilitates a valuable exchange of skills and expertise between the Bank and the broader global economic and financial policymaking community.

Community Engagement

Community engagement is important in ensuring that the Reserve Bank succeeds in promoting the public interest, which is a core value of the Bank. Staff in the Bank's Head Office and State Offices work to ensure that the Bank's role and actions are well understood by the community and that the Bank in turn understands the community's perspectives. The Bank supports academic research and education and also engages with the public through the Reserve Bank of Australia Museum.

Reserve Bank staff work to ensure that the Bank's role and actions are explained to the public, business and government, and that community perspectives, priorities and concerns in turn are understood by Bank staff. In addition to the specific details of community engagement set out in this chapter, many more individual engagements of Bank staff – from the Governor through to staff from all parts of the Bank – occur each week with different individuals and groups throughout the community. These range from the public speeches given by senior Bank staff, as discussed in the chapter on 'Accountability and Communication', to small private discussions.

As noted in the chapter on 'Governance', the Reserve Bank Board meets in state capitals on a regular basis. In the case of Adelaide, Brisbane, Melbourne and Perth, where the Reserve Bank has offices, the Board meeting is held in the Bank's office. A dinner with senior members of the local community is held in the evening following the Board meeting. These dinners, which are attended by political, business and public sector leaders, as well as representatives of the education, not-for-profit and other sectors, provide an opportunity for relationships between local communities and the Bank to be strengthened. A dinner with senior members of the Sydney community is held every two to three years with the same objective. In 2016/17, dinners were held in Sydney in September 2016 and in Melbourne in April 2017.

Reserve Bank of Australia Museum

The Reserve Bank's Museum houses a permanent collection of artefacts and hosts periodic exhibitions. It also offers regular talks and tours for visitors and students. Visitors can view the various types of money used before Federation through to the innovative next generation banknotes, including the new $5 banknote, which was launched in September 2016. Visitors can observe the evolution of the nation's identity as expressed through its banknotes and learn about the influential women and men depicted on them. They can also study the artwork used in banknote design, learn about how banknotes are made and discover their security features.

To mark the launch of the new $5 banknote, the museum added a display to its permanent collection entitled *A New Vision for Banknotes*. This display was designed to capture the innovative

Kaja Troa (Information Department) speaking to students during school holidays, November 2016

qualities of the new banknotes as well as the fact that these banknotes allow the vision-impaired community to recognise each denomination more easily by having a tactile feature, which was introduced for this series. The display showcases the new $5 banknote, its artistic design and production process. In addition, a large multi-touch screen enables visitors to explore the design elements and security features of the new banknote, along with historical and contextual information about the national stories that are depicted on the note. The screen enables additional information to be displayed and provides visitors with an interactive learning experience.

Following the release of the new banknote, a book was produced entitled *Notable Australians*. It documents the historical figures portrayed on each Australian banknote since portraits were introduced in the 1920s, and it reveals the gradual broadening of the identities included on the banknotes to be more inclusive of the range of men and women who have contributed to the nation. The book serves as a catalogue for the museum's collection and is an educational resource for students of history and design.

Given the ongoing commemoration of the centenary of World War I in the community, the museum has retained its temporary exhibition entitled *Before Sunset: The Bank & World War I*. The exhibition shows how World War I was associated with the emergence of central banking in Australia. The exhibition explains central bank functions, originally performed by a part of the Commonwealth Bank of Australia that later became the Reserve Bank, and showcases artefacts related to the Bank's involvement in the war, including financial documents and rare letters sent to the Governor of the day from the battlefields.

Around 15 000 people visited the museum during 2016/17, a slight decline from the previous year, with access restricted by building works. Nearly two-thirds of visitors were educational groups, spanning primary schools, secondary

Around 15 000 people visited the museum during 2016/17

(Top) Dung Nguyen from Note Issue Department conducts a presentation on the new $5 banknote at the multi-touch screen display in the Reserve Bank of Australia Museum during Sydney Open, November 2016; (above) Reserve Bank staff explore the multi-touch screen display in the museum, September 2016

(Top) The Head Office foyer during Sydney Open, November 2016; (above) Sydney Open visitors watch *Planned for Progress*, a film depicting the construction of the Reserve Bank's Head Office building, November 2016

schools and universities. The number of secondary school students visiting the museum increased by around 15 per cent over the year, to account for nearly half of all visitors, with this increase reflecting the expansion of the Reserve Bank's public education program. Visiting groups can receive talks about the role of the Bank, the economy, the new banknotes or museum exhibits.

The Reserve Bank again participated in Sydney Open in 2016 – an event designed to give the public access to important or unique buildings – with over 1 400 visitors to the Bank's public foyer areas and attending talks in the museum about the architecture and design of the heritage-listed Head Office building. Smaller groups enjoyed access to select parts of the building (including, for the first time, the boardroom), where they learned about the central banking activities undertaken in these spaces. They also learned about their unique architecture and design features, which form part of the cultural legacy of former Governor HC Coombs.

Most of the information in the museum is depicted on the museum's website. Additional resources were added to the museum website in 2016/17, including an expansion of the existing online exhibition associated with World War I to mark the centenaries of key battles in which former Bank staff were involved. There was also an online exhibition to mark the centenary of the birth of Sidney Nolan – an artist with a significant connection to HC Coombs and whose work forms part of the Bank's archival collection.

Public Education

The Reserve Bank significantly expanded and formalised its approach to public education during the year in review, with the establishment of a dedicated Public Access & Education team to support the needs of educators and students and coordinate the efforts of staff across the Bank in the delivery of a public education program. The initial focus of the team is on supporting economics educators and students at secondary and tertiary level, a group identified as being in particular need.

The number of high school students studying economics in Year 12 has fallen by around 70 per cent over the past 25 years, based on data available for the major states. The share of

Cathie Close (Queensland Office) presenting at Toowoomba Grammar School, November 2016 high schools offering economics as a subject has also fallen significantly over this period, with the decrease being most pronounced in government schools. In addition, females have accounted for a declining share of high school economic students. This is resulting in a student base for economics that is diminishing in size and diversity. The Bank is aiming to help redress this by ensuring that students have a stronger appreciation of what economics is, its relevance and the career opportunities it provides.

To that end, the Reserve Bank established an Educators Advisory Panel comprising external education experts to advise on the strategic direction of the Bank's public education program; this panel met for the first time in June 2017. The Bank also expanded the number and types of talks given to educators and students, ensuring that the content provided is aligned with curricula. As well as hosting many more talks to students and educators who visit the Bank's museum, talks were given across the country, with this outreach supported by staff in the Bank's State Offices as well as staff from Head Office. In addition, a program has commenced to visit schools and deliver talks in classrooms, helping to ensure equitable access to Bank resources.

In June 2017, the Reserve Bank hosted a professional development day for economics teachers, inviting teachers from all states to attend a series of sessions related to Year 12 economics curricula. The sessions covered some of the most requested economic topic areas that relate to the Bank's responsibilities. The teachers were addressed by the Governor and Deputy Governor, with presentations given by senior staff responsible for each of the Bank's charter functions, along with a cross-section of Bank economists.

Reserve Bank staff presented to 5 800 students and 400 educators across the secondary and tertiary sectors

In the six months since the introduction of the public education program at the start of 2017, Reserve Bank staff have presented to 5 800 students and 400 educators across the secondary and tertiary sectors.

Assistance for Research and Education

The Reserve Bank sponsors Australian and international economic research in areas that are closely aligned with its primary responsibilities. This sponsorship includes financial support for conferences, workshops, data gathering, journals and special research projects, and encompasses areas of study such as macroeconomics, econometrics and finance. In addition, the Bank provides financial support for the activities of the Centre for Independent Studies and the Sydney Institute. It is a corporate member of the Lowy Institute for International Policy and a member organisation of the Committee for Economic Development of Australia (CEDA); the



At the Teacher Immersion Event held in Head Office, June 2017: (top left) Head of Economic Analysis Department Alexandra Heath; (top right) Governor Philip Lowe; (above left) Head of Information Department Jacqui Dwyer; (above right) Alexandra Brown of the Reserve Bank's Economic Group

Bank's membership of CEDA includes an annual research contribution.

In 2016/17, the Reserve Bank continued its longstanding contribution towards the cost of a monthly survey of inflationary expectations undertaken by the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne. The Bank also maintained its contribution towards a quarterly survey of union inflationary and wage expectations undertaken by the Australian Council of Trade Unions.

The Reserve Bank continued to provide financial support for the *International Journal of Central Banking*, the primary objectives of which are to disseminate first-class, policy-relevant and applied research on central banking and to promote communication among researchers both inside and outside central banks. In his position as Governor, Glenn Stevens AC was a member of The Bretton Woods Committee, whose programs and publications aim to promote economic growth, reduce poverty and maintain financial stability globally. The membership entailed a modest annual financial contribution.

Financial assistance to Australian universities each year includes contributions towards the cost of conferences on economics and closely related fields. In 2016/17, these conferences included: the Economic Society of Australia's Australian Conference of Economists, held in Sydney; the 22nd Melbourne Money and Finance Conference; the University of New South Wales 29th Australasian Finance & Banking Conference; the Paul Woolley Centre for the Study of Capital Market Dysfunctionality Conference 2016, hosted by the University of Technology Sydney; the 29th PhD Conference in Economics and Business held at the University of Western Australia; the Women in Economics Retreat, held in Bowral, organised by the Economic Society of Australia; the International Conference on Financial Cycles, Interconnectedness, Systemic Risk and Policy Options for Resilience, organised by the University of New South Wales; the Melbourne Institute Macroeconomic Policy Meetings; and the 2016 Workshop of the Australasian Macroeconomics Society, held at the University of Queensland. The Reserve Bank also supports the discussion of economic issues in the community by providing a venue for the Economic Society of Australia's Lunchtime Seminar and the Emerging Economist Series.

The Reserve Bank sponsored an essay competition across Australia, designed to engage and support undergraduate students interested in economics. The RBA/ESA Economics Competition was organised jointly with the Economic Society of Australia and the University of New South Wales Economics Society. In 2016, students were invited to discuss how an environment of low interest rates might affect conventional monetary policy transmission channels, and policy options in such an environment. The winning essay was written by Elizabeth Baldwin (University of Queensland), the runner-up was Shaun Ji-Thompson (University of Queensland), and the best essay from a first-year student was by Timothy Grey (University of Sydney). The Governor presented these students with prizes at a ceremony at the Bank in October 2016.

In conjunction with the Australian Prudential Regulation Authority (APRA), the Reserve Bank has continued to sponsor the Brian Gray Scholarship Program, initiated in 2002 in memory of a former senior officer of the Bank and APRA. Four scholarships were awarded under this program in 2017. The cost to the Bank of these scholarships in 2016/17 was $30 000.

The total value of support offered for research and education in 2016/17 was $294 229.

During the year in review, the Reserve Bank responded to over 200 research requests for information from its Archives. Researchers making such requests included academics, post-graduate students, authors, numismatists, philatelists, heritage consultants, genealogists

The total value of support offered for research and education in 2016/17 was $294 229

Governor Philip Lowe with winners of the 2016 RBA/ESA Economics Competition (from left) Timothy Grey, Elizabeth Baldwin and Shaun Ji-Thompson, October 2016

and local history groups. The Archives contain a rich collection of records about the Bank's own activities as well as those of financial institutions in Australia that predate the creation of the central bank as a separate institution. There has been an increase in the number of requests relating to historical episodes of financial crisis, Britain's accession into the European Economic Community, Australia's engagement with Asia and the float of the Australian dollar. Following the launch of the new Australian banknote series, there was a significant increase in requests for information related to earlier banknote series, along with requests related to the Bank's rich photographic collection. A substantive long-term research request related to a local history group seeking a heritage listing for the Bank's old Note Printing Branch building in Fitzroy, Victoria, with research assistance by the Bank's archivists resulting in a successful application.

The program to digitise the Reserve Bank's most significant archival records continued during the year in review, with hundreds of thousands of records (including rare colonial ledgers and economic reports spanning the twentieth century) scanned and being made available electronically to researchers.

The Reserve Bank's Historian, Professor Selwyn Cornish of the Australian National University, is at an advanced stage of his research for the next volume of the official history of the Reserve Bank, which covers the period 1975–2000.

Charitable Activities

During 2016/17, the Reserve Bank made its 15th annual contribution of $50 000 to the Financial Markets Foundation for Children, which is chaired by the Governor. For many years, the Bank has donated a signed uncut banknote sheet to the ASX Thomson Reuters Charity Foundation for auction, which usually raises over $30 000. The Foundation includes the Financial Markets Foundation for Children in the distribution of auction proceeds. In July 2017, the Governor made his first address to the Anika Foundation's annual public event to raise funds to support research into adolescent depression and suicide; this was the 12th such event supported by the Bank.

The Reserve Bank's corporate philanthropy program involves several initiatives, key among which involves dollar-matching staff payroll deductions (totalling $97 500 in 2016/17) organised by the Reserve Bank Benevolent Fund.

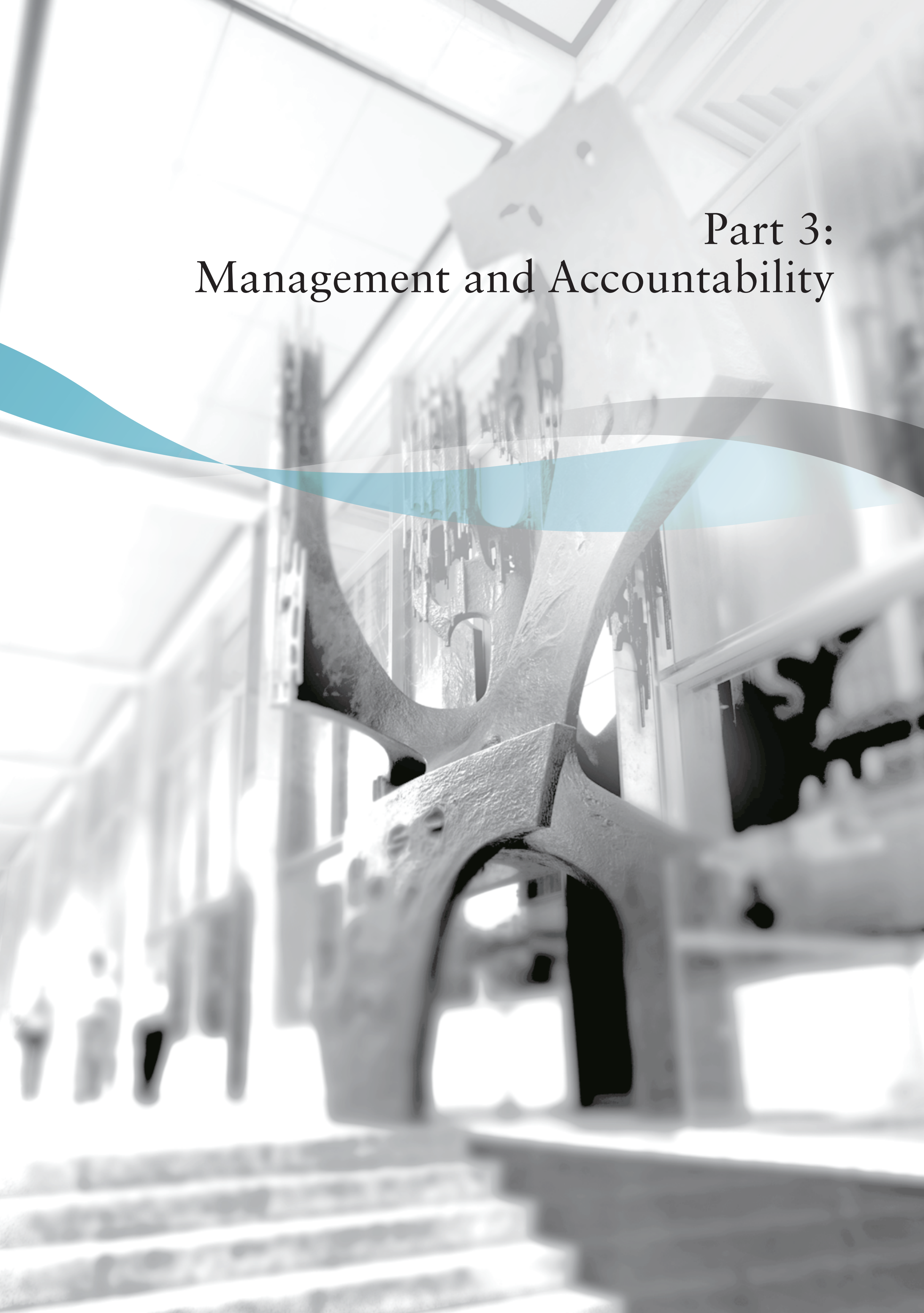
Reserve Bank staff participated in a number of volunteering activities in 2016/17 with The Smith Family, Foodbank and Oxfam Australia.

The Reserve Bank's contributions under all these initiatives in 2016/17 totalled $162 477. In addition, the Bank facilitates staff salary sacrificing under a Workplace Giving Program.

The Bank's charitable contribution in 2016/17 totalled $162 477

The Reserve Bank Benevolent Fund organises a Bank team to go to the Foodbank warehouse in Glendenning each year. During their 2016 visit they put together 600 hampers for Christmas, November 2016

Part 3:
Management and Accountability

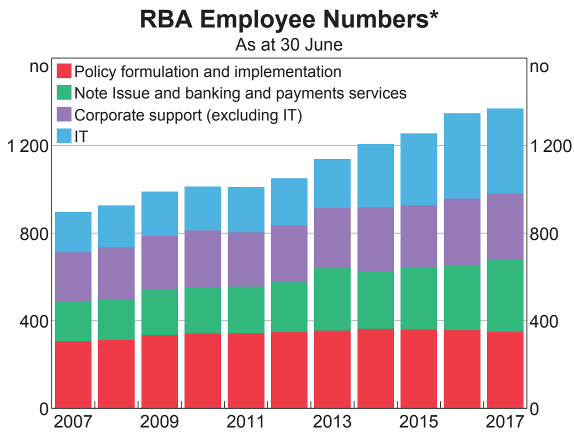


Our People

The Reserve Bank seeks to attract, develop and retain high-quality people who work productively together in order to achieve the Bank's objectives in a way that is consistent with its values. This is supported by the Bank's People and Culture Strategy, which in 2016/17 focused on leadership development, diversity and inclusion. In 2016/17 the proportion of women in management positions increased by 1 percentage point and the Bank created additional employment opportunities for Indigenous Australians and people with a disability. The total number of employees increased by 2 per cent, which was a smaller increase than in recent years as the Bank's project workload reached its peak.

Workforce Profile

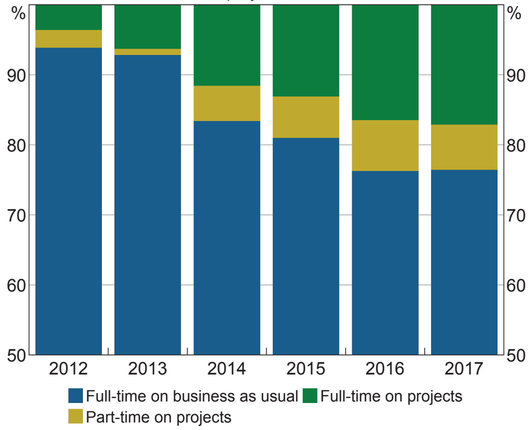
In June 2017, the Reserve Bank (excluding Note Printing Australia Limited) had 1 369 employees, of which 8 per cent worked part time. As such, the Bank's workforce comprised 1 339 full-time equivalent (FTE) employees. Half of the Bank's workforce is in the areas of policy formulation and implementation, note issue, banking and payments services. The Bank also employs a large number of people in information technology (IT), including those helping to deliver the Bank's program of major strategic projects. As these projects are completed, some reduction in employee numbers is expected in 2017/18.



* Excludes NPA
Source: RBA

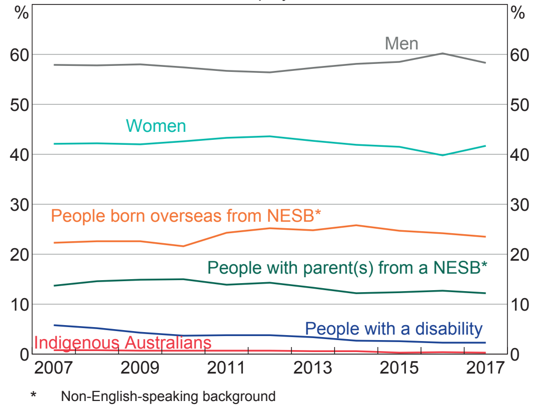
During the year, the Reserve Bank hired 202 employees, of which 77 per cent were recruited on fixed-term contracts largely to support project-related work. The new recruits included IT and project-related professionals. For non-project-related work, recruitment has taken place across all areas of the Bank. The graduate and internship programs continue to be an important recruitment channel for the Bank. In the year to June 2017, the Bank hired 35 graduates and 22 vacation-work interns. These graduates and interns work in the Bank's policy, note issue, banking, payments and corporate services areas, and hold degrees in commerce, economics, engineering, law and other professional disciplines. The Bank's workforce diversity profile has remained relatively stable over recent years, as shown in the graph below.

RBA Employees Working on Projects*



* Excludes NPA; calculation methodology revised in 2016
Source: RBA

Diversity Profile at the RBA



* Non-English-speaking background
Source: RBA

The average age of Reserve Bank employees is 39 years, with two-fifths of employees under the age of 35. This reflects the Bank's strong focus on early career hires each year through its graduate, internship and traineeship programs. The median tenure of employees is five years. During 2016/17, around 13 per cent of employees left the Bank. Resignations and retirements accounted for more than half of these exits. Contract expiration accounted for one-third of exits, given the high level of project-related work under way.

The Reserve Bank's 2017 graduate recruits during their orientation week, February 2017

People and Culture

The Reserve Bank's core values, as set out in its Code of Conduct, help shape the Bank's culture and guide expectations and standards around workplace behaviour and professional conduct. The Bank's values are as follows.

1. Promotion of the public interest

We serve the public interest. We ensure that our efforts are directed to this objective, and not to serving our own interests or the interests of any other person or group.

2. Integrity

We are honest in our dealings with others within and outside the Bank. We are open and clear in our dealings with our colleagues. We take appropriate action if we are aware of others who are not acting properly.

3. Excellence

We strive for technical and professional excellence.

4. Intelligent inquiry

We think carefully about the work we do and how we undertake it. We encourage debate, ask questions and speak up when we have concerns.

5. Respect

We treat one another with respect and courtesy. We value one another's views and contributions.

The Reserve Bank maintained a strong focus on its multi-year People and Culture Strategy, as it transitioned to a new senior executive team in 2016/17, led by Philip Lowe as Governor and Guy Debelle as Deputy Governor. The People and Culture Strategy continued to seek to:

- identify aspects of the Bank's culture and work environment that are strengths, as well as areas that need improvement, and measure progress in making improvements

The People and Culture Strategy focused on leadership development, diversity and inclusion

- develop a deep and diverse pool of well-trained potential leaders
- fully utilise the talents of the Bank's people
- foster an inclusive and flexible work environment.

To support the first objective of the People and Culture Strategy, Reserve Bank staff continued to be involved in the implementation of departmental and organisation-wide employee engagement survey action plans in 2016/17. The Governor also commenced holding 'Town Hall' meetings, which periodically bring together all staff to discuss the Bank's strengths and opportunities, as well as other organisational matters.

The Reserve Bank continued its focus on leadership development, talent management and diversity and inclusion during the year in review. The Bank's senior leaders completed an Executive Leadership Development Program and a new Empowering Leaders Development Program was introduced for the next cohort of future leaders.

The People and Culture Strategy also places emphasis on ensuring that the talents of employees are being fully utilised and developed. On-the-job development opportunities are supplemented by formal training and professional development programs, including:

- the eight-week Internship Program, which provides high-performing university students work experience and training through the completion of an applied research project. This program is an important source of early career professionals for the Reserve Bank's Graduate Development Program. In 2016/17, 22 interns joined the Bank
- the two-year Graduate Development Program, consisting of a range of tailored training programs to develop policymaking frameworks, effective business writing, critical thinking, presentation, communication and negotiation skills. A total of 61 graduates participated in the 2016/17 programs
- training as required in technical, management and leadership skills, resilience and other general competencies, such as communication skills

The People and Culture Strategy places emphasis on ensuring that the talents of employees are fully utilised

The average age of employees is 39 years, with two-fifths under the age of 35

- regular training in the Bank's compliance obligations, including in relation to work health and safety, fraud awareness and anti-money laundering/counter-terrorism financing.

Development opportunities are provided to employees by facilitating internal rotation programs between different areas of the Reserve Bank and external secondments. In 2016/17, the breadth of secondment activities increased, involving a wider range of Australian and international institutions, including the Commonwealth Department of the Prime Minister and Cabinet, the Australian Treasury, the Australian Bureau of Statistics, the Australian Competition and Consumer Commission, the Australian Prudential Regulation Authority, the Bank of England, the Bank for International Settlements, the Reserve Bank of New Zealand, the Federal Reserve, the International Monetary Fund and the Organisation for Economic Co-operation and Development. The Bank also hosts secondees from external institutions to foster corporate networks and share understanding of best practice.

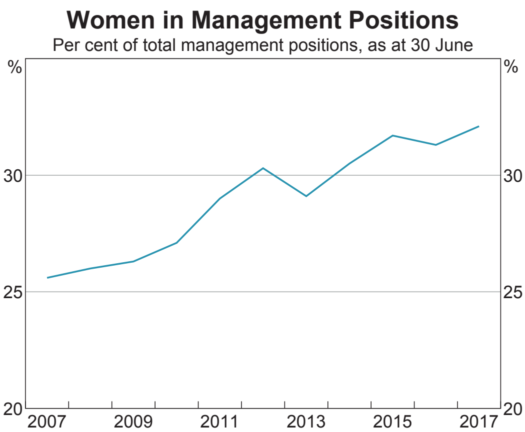
The Reserve Bank encourages employees to develop their skills continually, and provides financial support to employees for part-time study in disciplines related to their work, with 67 employees benefiting from this support during 2016/17. In addition, the Bank provided support to seven employees undertaking full-time postgraduate study at universities in Australia and overseas during this period.

The Reserve Bank recognises staff achievements through its Outstanding Achievement Awards program, which emphasises the principles of non-financial rewards and recognition.

The People and Culture Strategy also actively promotes an inclusive work environment. The Reserve Bank launched a suite of Employee Resource Groups (ERGs), which involve over 130 employees working together on issues related to accessibility, flexibility, gender equity, Indigenous Australians, LGBTI, and race and cultural identity. These groups work closely with the Bank's Diversity and Inclusion Council to establish and implement activities and practices

(Top) Chief Information Officer Sarv Girn speaking at a Reserve Bank IT Town Hall event, March 2017; (above) Around 60 women from the IT Department attended a presentation by MIT Research Scientist Dr Kristine Dery, organised by the Reserve Bank's Women in Technology community, December 2016

(Left) Diversity Discussion Series speakers Elizabeth Wing, Acting President of the NSW Anti-Discrimination Board, and Dr Tim Soutphommassane, Race Discrimination Commissioner, with Melissa Hope, Reserve Bank Head of Human Resources Department, October 2016; (right) Former White House economic adviser Associate Professor Betsey Stevenson during a talk on gender equity and diversity in the Reserve Bank's Head Office, March 2017



Source: RBA

During 2016/17, further progress was made towards increasing the representation of women in management at the Reserve Bank, with the share of management positions held by women increasing to 32 per cent in June 2017, 1 percentage point higher than a year earlier. The Bank has a gender target of 35 per cent of management positions to be filled by women by 2020, with a longer-term aim of 50 per cent. In support of the gender target, there is a strong focus on talent management at the

that support the Bank's Diversity and Inclusion Plan and contribute to an inclusive and flexible workplace environment for all employees.

The Reserve Bank continues to support flexible work practices, including part-time work and job-share arrangements. The Bank also enables flexible ways of working full time, by supporting changes in work patterns or location, including altering start or finish times, working compressed work weeks or from home or another location. About 36 employees commenced a flexible work arrangement in 2016/17.

The share of **management positions** held by **women** was **32 per cent** in June 2017

Bank, including succession and development planning for both women and men, and measures to ensure diversity of candidates in all selection processes.

The Reserve Bank actively works to promote economics, finance, mathematics and IT as career options for women. The Bank established a dedicated Public Access & Education team to expand the Bank's provision of learning experiences and information to schools, universities and educators about the economy and the role of Australia's central bank (see the chapter on 'Community Engagement'). The Bank also launched an annual scholarship for teachers in 2016 to help promote and support the study of economics in schools, particularly by females. The first scholarship recipient worked closely with the Bank during the year in review on a research project examining factors that may encourage the participation of female students in economics at secondary and tertiary levels. A new scholarship will be awarded to a teacher in August 2017.

Intern Tui Nolan (right) with his supervisor Michael Tran (Domestic Markets Department), February 2017

To promote the inclusion of Indigenous Australians in the workplace, during the year the Reserve Bank established a Reconciliation Action Plan (RAP) Working Group, which is developing the Bank's first RAP. The Bank-funded internship for Indigenous Australian university students was also expanded from one to four recipients in 2016/17, with one of the interns continuing in employment at the Bank. The internship was facilitated by Career Trackers, a not-for-profit agency that works with organisations to provide work experience, networking and professional development opportunities for Indigenous

To promote the inclusion of Indigenous Australians in the workplace, the Bank is developing its Reconciliation Action Plan

Australian university students. The internship involved vacation work at the Bank as well as professional development training. The Bank also welcomed two tertiary students with a disability through the Australian Network on Disability's 'Stepping Into' internship program and continues to provide long-term employment for individuals with intellectual disabilities through the Job Support program.

The Reserve Bank raised employees' awareness and involvement in diversity and work health and safety matters by supporting participation in external events and hosting guests at the Bank to speak on diversity, inclusion and health-related topics. Diversity events included speakers on gender and race matters, along with celebrations to mark NAIDOC week, Reconciliation Week,

(Top) Members of the Race and Cultural Identity ERG on Harmony Day (from left) Chris Aylmer (Executive Sponsor), Aman Chandra, Daniel Ji, Siew Geck Phua, Claudia Theresia, Claudia Seibold, Rhea Chakrabarty, Christine Chang, Joel Pillar, Kanwaljit Bathh, Lily Yang, Sarah Hepburn and Juraj Vidovenec, March 2017; Promoting Harmony Day: (above left) Deputy Governor Guy Debelle; (above centre) Head of Risk and Compliance Department Chris Aylmer; (above right) Deputy Head of IT Department Gayan Benedict

Harmony Day, Wear It Purple Day, International Women's Day and Global Accessibility Awareness Day. In addition, the Bank continued to raise awareness about mental health in the workplace, including through R U OK?Day activities. The Bank also developed a mental health strategy to support the prevention of workplace mental health issues, to be implemented in 2017/18, and provided training and advice to employees on mental health and resilience.

Remuneration

The remuneration packages for Reserve Bank employees are designed to attract and engage high-calibre people. In line with the Bank's commitment to openness and transparency, the distribution of remuneration paid to Bank executives and other senior employees is set out on page 104.

The Reserve Bank negotiated a new three-year Workplace Agreement for the period commencing 3 July 2017, which provides for a performance-based salary increase distributed from a pool equivalent to 2 per cent of salaries. As in the past, the new agreement makes available a moderate additional lump-sum performance-based payment. The salary increases are in line with the previous agreement. The agreement maintained the increase of hours in the standard work week for all employees introduced in 2016 and accommodates contemporary practices for shift work to support 24/7 operations.

During 2016/17, the Reserve Bank and the Officers' Superannuation Fund (OSF) Trustees completed the successor fund transfer of the Reserve Bank superannuation fund, the OSF, to RB Super, which is a corporate sub-plan within Sunsuper. The decision to do this was made to ensure that the increasing regulatory and governance requirements for superannuation funds are best able to be met. After a competitive selection process, Sunsuper was appointed to be the successor fund for the OSF in mid 2016, and the transition was completed on 21 March 2017.

Remuneration of Executives

Remuneration paid to executives in 2016/17($)[(a)]

Remuneration band	Number	Reportable salary[1]	Superannuation[2]	Lump sum[3]	Total
$0 to $200 000	1	145 026	23 831	3 911	172 768
$225 001 to $250 000	1	195 174	32 309	–	227 483
$250 001 to $275 000	1	233 932	37 062	3 873	274 867
$275 001 to $300 000	1	252 613	42 306	4 581	299 500
$300 001 to $325 000	10	264 972	43 955	3 915	312 842
$325 001 to $350 000	8	282 925	44 671	5 734	333 330
$350 001 to $375 000	3	297 980	50 212	5 482	353 674
$375 001 to $400 000	4	324 329	53 979	6 371	384 679
$400 001 to $425 000	1	354 094	60 412	6 739	421 245
$425 001 to $450 000	1	358 026	62 258	8 149	428 433
$450 001 to $475 000	2	388 668	66 900	5 725	461 293
$475 001 to $500 000	3	409 973	71 047	7 176	488 196
$500 001 to $525 000	3	435 315	62 850	9 860	508 025
$525 001 to $550 000	2	448 224	77 665	7 985	533 874
$550 001 to $575 000	1	465 989	78 912	8 364	553 265
$575 001 to $600 000	1	500 594	87 765	9 325	597 684
$600 001 to $625 000	1	506 803	88 827	9 438	605 068
$675 001 to $700 000	1	562 356	102 083	10 689	675 128
$725 001 to $750 000	1	631 623	98 736	9 897	740 256
$925 001 to $950 000	1	802 222	128 440	–	930 662
Total	**47**				

(a) Includes total remuneration earned in Australia during the reporting period by executives at desk (or on parental or annual leave) as at 1 July 2017; each row shows an average figure based on the number of employees within each remuneration band based on total remuneration earned; an executive for the purpose of this table is anyone holding a position of Deputy Head of Department (or equivalent) or above; see the numbered footnotes in the table below

Source: RBA

Remuneration of Other Senior Employees

Remuneration paid to other senior employees in 2016/17($)[(a)]

Remuneration band	Number	Reportable salary[1]	Superannuation[2]	Lump sum[3]	Total
$200 001 to $225 000	55	177 468	30 226	3 295	210 989
$225 001 to $250 000	39	199 858	33 537	3 749	237 144
$250 001 to $275 000	16	219 770	37 382	4 480	261 632
$275 001 to $300 000	5	247 894	39 042	5 168	292 104
Total	**115**				

(a) Includes total remuneration earned in Australia during the reporting period by other senior employees at desk (or on parental or annual leave) as at 1 July 2017; each row shows an average figure based on the number of employees within each remuneration band based on total remuneration earned

Source: RBA

Notes

(1) The 'reportable salary' column is prepared on a cash basis using reportable salary, defined as the sum of gross payments (excluding lump sum payments); reportable fringe benefits (net amount); reportable employer superannuation contributions; and exempt foreign employment income, as reported in an individual's payment summary.

(2) The 'contributed superannuation' column is calculated as: the actual defined contribution amounts for individuals who are in a defined contribution scheme; and for individuals who are in a defined benefit scheme, an amount equal to 15.4 per cent of superannuable salary plus employer productivity contributions.

(3) The 'lump sum' column is prepared on a cash basis using actual lump sum performance-based payments paid to individuals during the reporting period.

Management of the Reserve Bank

Much of the Reserve Bank's call on resources comes from ongoing activities associated with its key policy and operational responsibilities. A number of ongoing major projects, designed to strengthen its operations, have added to the Bank's costs in recent years. Several of these were brought to completion in 2016/17 and, as the remainder are completed in coming years, project costs are expected to return to historical levels.

The Reserve Bank's Costs

Project-related costs remained high by historical standards in 2016/17, as the effort to successfully deliver the program of major strategic projects continued. However, expenditure on projects is expected to fall from around mid 2017 as this portfolio is progressively completed. Costs associated with the Reserve Bank's ongoing activities rose largely as a result of new support activities associated with completed projects adding to existing costs.

The portfolio of projects largely comprises initiatives to support the continued effectiveness of the Reserve Bank's policy and central banking operations. Many of these projects are technology intensive and their completion will strengthen Australia's financial infrastructure. In 2016/17, some projects that had begun in previous years were completed while substantial progress was made on the delivery of others. The portfolio of projects generally remains within budget and on schedule.

Project work relating to banknote production and distribution continues to be an important area of focus. Associated with the introduction of the new series of banknotes is a range of related projects that focuses on logistics. Each element of this is now well advanced. The construction of the new banknote storage facility, the National Banknote Site (NBS) at Craigieburn in Victoria, was completed in March 2017. The NBS is highly secure and custom built for the storage, processing and distribution of banknotes. This project, which was approved by the Parliamentary Public Works Committee in February 2014, involved complex design, engineering and construction challenges related to security, operational and safety requirements. Final commissioning of the new facility is under way and the building is expected to be fully operational by early 2018. It will expand the current capacity of banknote storage and processing to accommodate operations associated with the issue of the new series of banknotes. The NBS will also accommodate machinery for validating and destroying banknotes that are returned from circulation, with the capacity to process both current and new banknote series. Costs associated with operating the NBS will be partially offset as the vault in the Reserve Bank's Melbourne CBD building ceases to be used.

(Top) The National Banknote Site, which took roughly 20 months to complete, under construction in June 2016; (above) Some of the key people involved in the planning, design and construction of the National Banknote Site at the unveiling ceremony: (front, from left) Michael Walker, Lindsay Boulton, Peter Billimoria (Watpac), Frank Campbell, Michele Bullock, Philip Lowe, Simon Page and Kate Reily; (second row, centre) Michael Andersen (left) and Ed Jacka, April 2017

The National Banknote Site, April 2017

The Reserve Bank continues to participate in the industry-led initiative to develop the New Payments Platform (NPP), which will allow low-value payments to be cleared and settled in near real time. The project is nearing completion to develop system-wide infrastructure for platforms that clear and settle transactions of authorised deposit-taking institutions resulting from low-value payments. The infrastructure for the Reserve Bank Information and Transfer System (RITS), which is Australia's high-value payments system, is also being strengthened as hardware is replaced within a more resilient and secure network structure, thereby further reducing risk in the interbank payments system. The ongoing operating costs of these banking and payments systems will, over time, be recovered from user fees. The Bank is also adapting its own banking systems so that its customers will be able to participate in the NPP, which is expected to commence operations around the end of 2017.

A number of projects were delivered in 2016/17 that will support the Reserve Bank's operations in financial markets. The Bank completed development on the Securitisations System, which facilitates more precise valuation of securitised instruments that may be used as collateral in the Bank's open market operations, strengthens associated risk management and houses data that will enable further research into securitised markets. The two-year project to upgrade the Bank's Treasury Management system was also successfully completed.

The outsourcing of the Reserve Bank staff superannuation fund was completed in March 2017. This will significantly reduce costs for both the Bank and fund members, and places the control and operation of this fund fully at arm's length from the Bank. (See the chapter on 'Our People' for further detail.)

Many of the Reserve Bank's activities and projects depend heavily on information technology (IT) systems and infrastructure. The Bank continues to pursue fit-for-purpose strategies to ensure IT assets are appropriately innovative, mature and resilient, and manage operational risk to acceptable levels. Significant resources have been applied to strengthening cyber security in recent years. The Bank has been certified as complying to a mature standard with the 'Top 35' strategies recommended by the Australian Signals Directorate (ASD) for containing cyber threats and will build on this as newer ASD strategies and standards evolve. The Bank has also attained certification of its internet gateway to the ISO 27001 global standard for Information Security Management.

The Reserve Bank has an ongoing program of investment to maintain the value of its physical assets, including buildings, to ensure that building services remain effective and resilient and that associated risks are managed appropriately. In 2016/17, there were a number of works at the Bank's Head Office in Martin Place in Sydney, including the installation of security bollards to strengthen perimeter security, upgrading the fire detection system and a mechanical upgrade of the passenger lifts.

General operating costs associated with running the Reserve Bank, as opposed to those associated with holding assets, making transactions or purchasing banknotes, rose by 11.0 per cent in 2016/17, with operating costs for ongoing activities, excluding depreciation and spending on projects, increasing by 4.6 per cent. The marked rise in non-staff costs largely reflected project-based activity and was related to the start-up of the NBS, new IT equipment for large projects, costs associated with the new banknote series and depreciation.

General Operating Costs[(a)]

$ million

	2012/13	2013/14[(b)]	2014/15	2015/16	2016/17
Staff costs	169.0	184.6	195.3	212.8	216.3
Other costs	76.8	87.9	89.0	97.4	128.0
General operating costs	245.8	272.5	284.3	310.3	344.3
General operating costs (excluding depreciation)	227.0	250.6	261.0	284.7	305.9
Of which: Cost of projects	11.8	18.4	28.0	34.9	44.8

(a) Excluding NPA and banknote management expenses, and costs directly linked with transaction-based revenue
(b) Some costs have subsequently been reclassified as general operating costs
Source: RBA

Capital Costs[a]
$ million

	2012/13	2013/14	2014/15	2015/16	2016/17
Capital costs	29.8	44.2	56.5	108.1	100.7
Of which:					
Cost of major projects[b]	7.8	18.6	42.9	92.8	85.8

(a) Excluding NPA
(b) Projects on the Bank's Enterprise Master Schedule
Source: RBA

Operating costs for ongoing activities are expected to rise further in 2017/18, with a further appreciable rise in depreciation from the progressive delivery of capital initiatives, and new operating costs associated with the operation of the NBS and from the transfer of certain banknote operations staff from Note Printing Australia Limited (NPA). Excluding depreciation and the transfer of these staff, total operating costs are budgeted to rise by 2.5 per cent in 2017/18.

The extent of the Reserve Bank's investment in its strategic initiatives is reflected in capital expenditure over recent years. Capital outlays, which were about $101 million in 2016/17, were concentrated on completing the NBS and on the major initiatives to develop technology and communications systems for the Bank's banking, payments and settlements, and financial markets activities. Capital spending is expected to fall by about 30 per cent in 2017/18 and to decline further in subsequent years.

External Review of the Reserve Bank's Operations

During the year, the Reserve Bank commissioned an external review of its operations to help gain assurance that those operations were being conducted in a way that is both appropriate and makes effective use of public money. The review was chaired by David Tune AO, assisted by a team from Deloitte Consulting. The review provided assurance that the Bank's support services were functioning well in helping pursue the Bank's objectives. The review made observations on possible opportunities for improvement to support the Bank's aim to be continuously improving as an organisation. In addition to a number of smaller observations for improvement, the review had two major observations, which were:

- A range of workplace processes and transactional areas of the Bank could be centralised into a unified and expanded shared services centre. This would allow for an improved experience for staff, reduce the administrative burden and, over time, drive process improvements. This will require consideration of how the support service functions could be organised to support greater consistency in processes, technology and service delivery across functions and business activities.
- Following a successful transformation of the IT function over the preceding five years, which has enabled the Bank to deliver its significant project load, the time is now right for IT to transition to a steady-state size and structure, with a lower project load. The review also suggested a re-assessment of the support model such that the cost and effort associated with projects is reduced and the interaction between IT and the various user areas across the Bank is enhanced.

The Bank is in the process of following through on these observations.

Facilities and Environmental Management

The Reserve Bank owns premises in locations where there is a business need to do so. These facilities include the Head Office in Sydney; the HC Coombs Centre for Financial Studies in Kirribilli, Sydney; office buildings in Melbourne and Canberra; the note-printing facility and NBS at Craigieburn, north of Melbourne; and the Business Resumption Site in north-west Sydney. In addition to the buildings it owns, the Bank leases accommodation for its State Offices in Adelaide, Brisbane and Perth and for its offices in London, New York and Beijing. Independent valuers estimated that the value of the Bank's property assets increased by $134 million to about $524 million in 2016/17, reflecting the completion of the NBS and higher property prices in Sydney and Melbourne.

Accommodation in the Reserve Bank's properties that is not required for its own business purposes is leased to external tenants. Almost all of this surplus space is currently let to tenants. Net income from these leases amounted to $11.4 million in 2016/17, compared with $11.2 million in the previous year.

The Reserve Bank is committed to improving the environmental performance of its operations. The Bank has developed policies that are in accordance with the principles of ecologically sustainable development as set out in the *Environment Protection and Biodiversity Conservation Act 1999*. These policies work to reduce the impact of the Bank's operations on the environment and include initiatives to:

- reduce energy, water and paper consumption
- increase the recycling of paper, co-mingled waste and printing cartridges
- adopt environmentally sustainable designs for office fit-outs
- use 50/50 recycled paper
- use biodegradable takeaway coffee cups in the staff cafeteria
- increase the use of fuel-efficient vehicles.

Compared with averages over the preceding five years, electricity consumption of all Reserve Bank-operated sites increased by 4.4 per cent in 2016/17. This reflected production demand at the Craigieburn facility, with higher operating rates associated with printing the new series of banknotes and the commencement of operations at the NBS. Increased loads in the Bank's data centres as a result of new systems coming into operation also contributed to higher electricity consumption. Gas and water consumption in 2016/17 declined by 3.6 per cent and 1.2 per cent respectively compared with the previous year, as a result of improvements to the heating system and the domestic hot water system in Head Office and more efficient boiler operations at the Craigieburn facility and Canberra Branch.

Consultancies

The Reserve Bank employs outside contractors and professional service providers to carry out specific tasks where necessary and also, from time to time, uses consultants. Consultants are engaged where the Bank lacks specialist expertise or if independent research, review or assessment is required. Consultants are typically engaged to: investigate or diagnose a defined issue or problem; carry out defined reviews or evaluations; or provide independent advice or information to assist in the Bank's decision-making. Prior to engaging consultants, the Bank takes into account the skills and resources required for the task, the skills available internally, and the cost-effectiveness of engaging external expertise. Spending on consultancies over the past eight years is shown below.

Spending on Consultancies[(a)]
$

2009/10	61 000
2010/11	102 000
2011/12	535 000
2012/13	1 190 000
2013/14	387 000
2014/15	773 000
2015/16	622 520
2016/17	987 388

(a) Sum of individual consultancies that cost $10 000 or more
Source: RBA

As in previous years, consultancies during 2016/17 covered a range of activities, with close to half of spending related to the external review of the Reserve Bank's operations commissioned by the Bank in early 2017; see the discussion earlier in this chapter for further detail. As in the previous year, there were also a number of consultancies related to the project to upgrade Australia's banknotes.

Risk Management

In meeting its objectives, the Reserve Bank takes on a number of risks. The framework through which these risks are managed is overseen by the Risk Management Committee, which is chaired by the Deputy Governor. Underpinning this framework is an active risk management culture.

Objectives and Governance Structure

In undertaking activities to support its objectives, the Reserve Bank assumes a number of risks. Management of these risks is integral to all aspects of the Bank's activities and is the responsibility of all staff. Managers have a particular responsibility to evaluate their risk environment, put in place appropriate controls and ensure that these controls are well developed and implemented effectively. The Bank identifies, assesses and manages risk at both an enterprise ('top-down') and business ('bottom-up') level, a process that is subject to ongoing review. These risks are managed to a level that is consistent with the Bank's risk appetite through processes that emphasise the importance of integrity, intelligent inquiry, maintaining high-quality staff and public accountability. The development and maintenance of an active risk management culture that acknowledges the need for careful analysis and management of risk in all business processes is an important objective of this framework.

Oversight of the Reserve Bank's arrangements for risk management is undertaken by the Risk Management Committee. The committee is chaired by the Deputy Governor and comprises: the Assistant Governors for the Business Services, Corporate Services and Financial Markets groups; the Chief Financial Officer; the Chief Information Officer; the Heads of the Audit, Human Resources, Information, and Risk and Compliance departments; and the General Counsel. The Risk Management Committee meets six times per year, or more frequently if required, and keeps the Executive Committee and the Reserve Bank Board Audit Committee informed about its activities.

The Risk Management Committee is responsible for ensuring the proper assessment and effective management of all the risks the Reserve Bank faces, with the exception of those arising directly from its monetary and financial stability policies and payments policy functions. These risks remain the responsibility of the Governor, the Reserve Bank Board and the Payments System Board. The risks associated with the Bank's shareholding in Note Printing Australia Limited (NPA) are overseen by the Reserve Bank Board and covered by the NPA Charter, although responsibility for the day-to-day activities of NPA rests with the NPA Board and management. The Bank's risk management framework covers the relationships that it has with NPA other than its shareholding – for example, joint participation in projects and the relationships of supplier, customer, landlord and tenant.

The Risk Management Committee is assisted in its responsibilities by the Risk and Compliance Department. The department's main role is to

The Reserve Bank has an active risk management culture that acknowledges the need for careful analysis and management of risk in all business processes

assist individual business areas to manage their risk environment effectively within a broadly consistent framework. It also monitors risk and performance associated with the Reserve Bank's activities in financial markets and supports the business areas by implementing Bank-wide control frameworks covering fraud control, anti-bribery and corruption measures, business continuity and compliance-related risks. The Head of Risk and Compliance Department reports directly to the Deputy Governor.

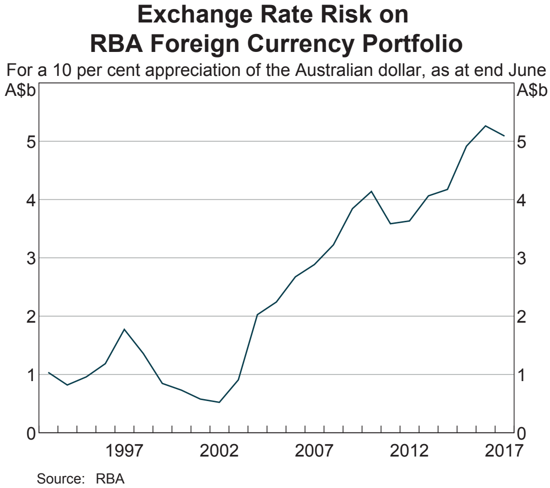
The Audit Department undertakes a risk-based audit program to provide assurance that risks are identified and key controls to mitigate these risks are well designed and working effectively. This includes periodic reviews of the Reserve Bank's risk management framework and testing key controls in business areas on a sample basis. The Head of Audit Department reports directly to the Deputy Governor and the Chair of the Reserve Bank Board Audit Committee.

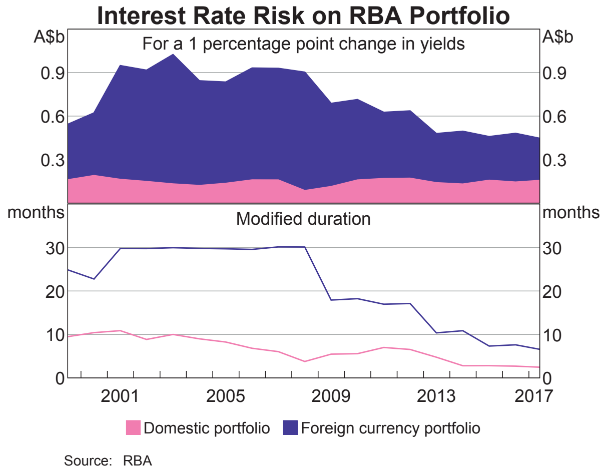
Portfolio Risks

The Reserve Bank holds domestic and foreign currency-denominated financial instruments to support its operations in financial markets in pursuit of its policy objectives. These instruments account for the majority of the Bank's assets and expose its balance sheet to a number of financial risks. The primary responsibility for managing these risks rests with the Financial Markets Group. The Risk and Compliance Department monitors these risks and assesses compliance with approved authorities and limits. Compliance with financial management guidelines and developments in portfolio risks are reported to the Risk Management Committee.

Exchange rate risk

The largest financial risk that the Reserve Bank is exposed to is exchange rate risk as a large share of the Bank's assets are denominated in foreign currency, while most of the Bank's liabilities are denominated in Australian dollars. As holdings of foreign currency-denominated assets serve a policy function, the Bank does not seek to eliminate or hedge this exposure. Rather, the Bank mitigates the risk by diversifying foreign currency assets across various currencies. The foreign benchmark portfolio has target shares of 55 per cent in US dollars, 20 per cent in euros and 5 per cent each in Japanese yen, Canadian dollars, UK pound sterling, Chinese renminbi and Korean won (see the chapter on 'Operations in Financial Markets' for more detail). This benchmark portfolio composition reflects the Bank's long-term risk and return preferences and requirements for liquidity and security. The Bank's holdings of gold and Special Drawing Rights (SDRs – a liability of the International Monetary Fund) are not managed relative to an internal benchmark. The Bank's Asian Bond fund investment is managed externally by the Bank for International Settlements.





The Australian dollar value of the Reserve Bank's foreign portfolio was little changed over 2016/17. Based on the level of reserves at 30 June 2017, a 10 per cent appreciation of the Australian dollar would result in a mark-to-market loss of $5.1 billion. The increase in exchange rate risk over the previous decade and a half mainly reflects the increase in the size of net foreign exchange reserves over that period.

Interest rate risk

The value of the Reserve Bank's financial assets is also exposed to movements in market interest rates, as the bulk of the domestic and foreign portfolios comprise fixed-income securities.

Total holdings of domestic securities increased by $18.9 billion over 2016/17 to $116.6 billion. Domestic securities held on a temporary basis under repurchase agreements (repos) accounted for $102.2 billion and securities held outright accounted for $14.4 billion. The increase in outright holdings of Australian Government Securities (AGS) over 2016/17 reflected the purchase of short-dated AGS. These purchases are used to manage the liquidity impact of maturing AGS. As these securities have a very short term-to-maturity, the overall sensitivity of the domestic portfolio to movements in market yields was little changed over the period.

In contrast to the domestic portfolio, the Reserve Bank's foreign currency assets are managed relative to benchmark portfolios in each currency with duration targets that reflect the Bank's long-term appetite for risk and return. These duration targets are reviewed periodically. The duration target for the US, European, Canadian and Japanese benchmark portfolios is six months and for the UK portfolio it is three months; the Chinese and Korean benchmark portfolios have a higher duration target of 18 months. The weighted-average benchmark duration target for the Bank's foreign portfolios fell slightly over 2016/17 to around 6½ months, reflecting a reduction in the duration target of the Chinese portfolio from 30 months to 18 months. This weighted average duration target is low by historical standards, reflecting the generally low level of interest rates, which offer little compensation for the risk of capital losses should longer-term bond yields return to more normal levels.

The overall level of interest rate risk on the Reserve Bank's domestic and foreign financial assets was little changed over 2016/17. The Bank would incur a valuation loss of around $445 million if interest rates in Australia and overseas rose uniformly by 1 percentage point across the yield curve.

The Reserve Bank is exposed to very little interest rate risk on its balance sheet liabilities. Banknotes

(Left) Banknote Ethics Initiative Principal Advisor Antti Heinonen; Reserve Bank Assistant Governor (Business Services) Lindsay Boulton (centre) and Crane Currency CEO Stephen DeFalco at a panel discussion on managing ethical risk at the Currency Conference, Kuala Lumpur, May 2017

on issue account for about 37 per cent of total liabilities and carry no interest cost to the Bank. The other sizeable obligations include deposits held by the Australian Government and its agencies, and Exchange Settlement Account balances held by authorised deposit-taking institutions (ADIs). These deposits have short maturities that broadly match the Bank's domestic assets held under repo. Interest paid on these deposits reflects domestic short-term interest rates, effectively hedging part of the interest rate exposure of the domestic asset portfolio.

Credit risk

Credit risk is the potential for financial loss arising from the default of a debtor or issuer, or from a decline in asset values following a deterioration in their credit quality. The Reserve Bank manages its credit exposure by applying a strict set of criteria to its holdings of financial assets and confining its dealings to highly creditworthy counterparties. In addition, the Bank's transactions are executed under internationally recognised legal agreements.

The Reserve Bank is exposed to very little issuer credit risk on its outright holdings in the domestic portfolio as it invests only in securities issued by the Australian Government or by state and territory government borrowing authorities. The Bank is exposed to a small amount of counterparty credit risk on domestic assets that are held under repo. The Bank would face a loss only if a counterparty failed to repurchase securities sold under repo and the market value of the securities fell below the agreed repurchase amount. The Bank manages this exposure by requiring that these securities meet certain eligibility criteria, and applying an appropriate margin to the securities, which is maintained throughout the term of the repo through two-way margining. The degree of over-collateralisation increases with the risk profile of the security. The Bank widened the eligibility criteria for longer-term ADI-issued securities in June 2017, but applied higher haircuts to the newly eligible securities (see the chapter on 'Operations in Financial Markets' for more detail).

The Reserve Bank does not apply credit ratings-based criteria to the counterparties with which it is willing to deal in carrying out policy operations in the domestic market. However, counterparties must be subject to an appropriate level of regulation and be able to ensure efficient and timely settlement of transactions within the Austraclear system. Repo transactions with the Reserve Bank are also governed by a Global Master Repurchase Agreement as part of the Reserve Bank Information and Transfer System (RITS) Regulations.

Investments in the Reserve Bank's foreign currency portfolio are typically confined to highly rated and liquid securities, as well as deposits with foreign central banks. The majority of the Bank's outright holdings are securities issued by the national governments of the United States, Germany, France, the Netherlands, Japan, Canada, the United Kingdom, China and South Korea, with modest holdings of securities issued by select highly rated supranational institutions and government agencies.

The Reserve Bank also holds a portion of its foreign currency portfolio in short-term repos. This exposes the Bank to the small amount of residual credit risk that is inherent in repos, as noted above. The Bank manages this risk by requiring 2 per cent over-collateralisation, which is maintained through two-way margining, and accepting only high-quality and liquid securities as collateral. Credit exposure on foreign repos is further managed by imposing limits on individual counterparty exposures and requiring execution of a Global Master Repurchase Agreement (or Master Repurchase Agreement where appropriate) with each counterparty.

The Reserve Bank undertakes foreign exchange swaps as part of its policy operations and as a means to enhance returns on the foreign currency portfolio. Credit risk on these instruments is managed by transacting only with counterparties that meet strict eligibility criteria, including the requirement to have executed with the Bank an International Swaps and Derivatives Association (ISDA) agreement with a credit support annex. Exposures on foreign exchange swaps generated by movements in market exchange and interest rates are managed through two-way margining.

Operational Risks

There are a diverse range of operational risks associated with the Reserve Bank's day-to-day activities. These risks range from software failure following system implementations to unauthorised access to systems and data, as well as the unintentional disclosure of confidential and sensitive information. Generally, the Bank has a low appetite for this type of risk. The Bank recognises that it cannot eliminate risk entirely from its operations and acceptance of some risk is often necessary to foster innovation and efficiencies in business practices.

While all parts of the organisation are exposed to operational risk of varying degrees, the most significant risks are those associated with financial transactions undertaken by the Reserve Bank for its own activities and that of its clients. During 2016/17, Financial Markets Group executed around 68 000 transactions, generating an average daily settlement value of around $32 billion. The Bank is also the primary banker for a number of government entities, including the Australian Taxation Office and Department of Human Services, and it maintains the infrastructure to facilitate real-time interbank payment and settlement services through RITS. Given the crucial role of these activities in the financial system, any operational failure could have widespread consequences. As a result, the Bank has in place a range of processes to facilitate ongoing and effective management of its operational risks in order to maintain a suitably robust control environment.

Extensive back-up plans have been established to ensure the continuity of critical business functions during and after a disruptive event such as a natural disaster, power outage or terrorist attack. These plans include the use of a dedicated Business Resumption Site (BRS) in north-west Sydney, where permanent staff from some of the Reserve Bank's most critical operational areas are located. All departments regularly test their back-up plans at the site, including combined exercises involving multiple areas to test the capacity of the facilities. Additionally, staff at the Bank regularly test back-up plans in a work-from-home environment, which covers scenarios where the Head Office and BRS may both be unavailable, such as a pandemic or transport disruption. The Bank also liaises with external organisations on business continuity matters, including participating in shared exercises to ensure that staff are well briefed in their roles during disruptions and that effective internal and external communication arrangements are in place. The results of exercises are monitored by the Risk Management Committee.

The Reserve Bank's policy and business operations are highly dependent on information technology (IT) systems. The Bank's risk management framework supports an ongoing focus on managing the risks associated with complex IT systems. A key element of this framework is the operation of the Technology Committee, which is chaired by the Assistant Governor (Corporate Services). This committee collaborates with relevant business areas to facilitate the monitoring, assessment and management of IT-related risks and ensure IT-related initiatives are consistent with the Bank's IT strategy. This work is supported by the continuous evaluation of industry developments in order to ensure that the Bank's systems conform to current IT standards and remain robust. Assessment of appropriate staff resourcing, the adequacy of controls over IT processes and the level of security over information management are all incorporated into the Bank's risk management framework.

During 2016/17, the Reserve Bank continued to direct significant resources towards the delivery of a number of large and complex multi-year projects. These include the renovation of banking applications and systems, the development of infrastructure to facilitate real-time retail payments and the upgrade of Australia's banknotes. Successful completion of these projects will ensure high-quality services are maintained for the Bank's clients and the Australian public. The risks associated with project work are carefully managed so that adequate resources are available, nominated project deadlines are met and change management is effective. Project steering committees play an important role in overseeing the management of these risks.

The Reserve Bank has no tolerance for fraud or other unethical behaviour. All staff involved in financial dealing have well-defined limits to their authority to take risks or otherwise commit the Bank. These arrangements are further enhanced by separate front-, back- and middle-office functions,

Extensive back-up plans have been established to ensure the continuity of critical business functions where staff involved in trading, settlement and reconciliation activity remain physically separate and have separate reporting lines. For non-trading activities, several layers of fraud controls are in place, including preventative, detective and corrective controls. A clear decision-making hierarchy, separation of duties and physical controls over systems and information are evident and are subject to regular review. Ongoing training and awareness programs are also conducted. In March 2017, the Bank rolled out a face-to-face Fraud Awareness training program for all staff. The Bank has arrangements in place for staff and members of the public to report concerns anonymously, and all concerns are fully investigated. During 2016/17, there was one reported instance of fraud against the Bank by an employee.

The effective management of compliance risk is central to the Reserve Bank's activities. Risk and Compliance Department collaborates with all business areas to ensure that this risk is being managed effectively and keeps the Risk Management Committee informed regarding the level of compliance in key areas. Staff also complete a number of compliance-based electronic training modules each year, focusing on areas such as privacy and workplace health and safety.

The Reserve Bank remains strongly committed to maintaining and strengthening a workplace culture in which employees uphold the highest standards of behaviour. A Code of Conduct is in place that sets out requirements of the Bank's employees and others who are involved in its activities. The code articulates the values that staff are expected to demonstrate when pursuing the Bank's objectives. These values require employees to conduct themselves with a high degree of integrity, strive for excellence in the work they perform, treat others with respect and courtesy, exercise intelligent inquiry and promote the public interest. All staff attest annually that they have read and understood the code.

The Reserve Bank remains strongly committed to a workplace in which employees uphold the highest standards of behaviour

Operational failures can occur from time to time regardless of a strong control framework. These occurrences may adversely affect the Reserve Bank's reputation or lead to financial or other costs. Timely reports on any such incidents are distributed to the Risk Management Committee, summarising the relevant circumstances and identifying areas where new controls may be needed or where existing controls should be strengthened.

Government Guarantee Scheme

The Reserve Bank continues to act as the administrator of the Guarantee of State and Territory Borrowing. Applications for new guaranteed liabilities under this scheme closed in 2010, although existing liabilities will continue to be guaranteed until maturity, at the latest in 2023. To date, a total of $410 million in fees has been collected for state and territory borrowing since the scheme commenced in 2009, with $14 million collected in 2016/17.

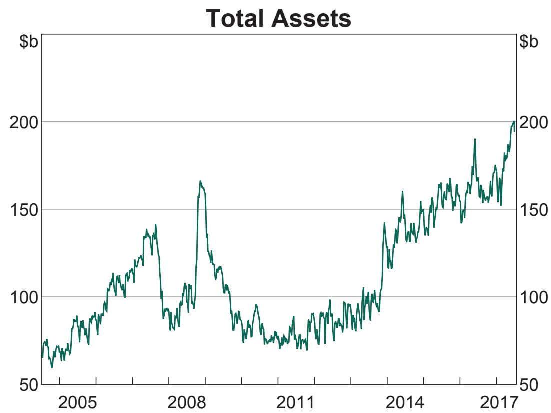
Earnings, Distribution and Capital

While the Reserve Bank earns a profit in most years, it also holds reserves sufficient to cover potential financial losses when they occur. In 2016/17, the Bank recorded an accounting loss of $0.9 billion, as unrealised valuation losses exceeded the sum of other components of profit. Despite the accounting loss, earnings of $1.3 billion were still available for distribution as, when determining distribution under the *Reserve Bank Act 1959*, unrealised valuation losses are offset against previously retained net unrealised valuation gains.

The Reserve Bank's Balance Sheet

The Reserve Bank holds a range of financial assets to pursue its monetary policy objectives and support an efficient and orderly payments system in Australia. The Bank also manages Australia's portfolio of international reserves. The portfolio of domestic securities is used to conduct market operations and manage liquidity in the cash market in Australia. The domestic portfolio is composed mainly of repurchase agreements, although the Bank also holds outright some domestic securities issued by the Australian government and state and territory borrowing authorities. Operations in the foreign exchange markets are primarily undertaken either on behalf of customers or to manage the foreign reserves. When appropriate, foreign exchange swaps are also undertaken to assist domestic liquidity management operations. The Bank's liabilities mainly comprise banknotes on issue, deposits of the Australian Government and other customers, and capital and reserves. See the chapter on 'Operations in Financial Markets' for further details.

The Reserve Bank's balance sheet was $194 billion on 30 June 2017, compared with $167 billion a year earlier. Banknotes on issue, the Reserve Bank's single largest liability, rose by about 5 per cent, to $74 billion, while deposits of the Australian Government rose by about $28 billion. Management of the Bank's assets is discussed in the chapter on 'Operations in Financial Markets'; the associated risks are considered in the chapter on 'Risk Management'.



Source: RBA

The Reserve Bank's Earnings

The Reserve Bank's earnings arise from two sources: underlying earnings – comprising net interest and fee income, less operating costs

– and valuation gains or losses. Net interest income arises because the Bank earns interest on almost all of its assets, albeit currently at low rates, while it pays no interest on a large portion of its liabilities, such as banknotes on issue and capital and reserves. Fees paid by authorised deposit-taking institutions associated with the Committed Liquidity Facility also make a significant contribution to underlying earnings.

Valuation gains and losses result from fluctuations in the value of the Reserve Bank's assets in response to movements in exchange rates or in yields on securities. A depreciation of the Australian dollar or a decline in interest rates results in valuation gains. Conversely, an appreciation of the Australian dollar or a rise in market yields leads to valuation losses. These gains and losses are realised only when the underlying asset is sold or matures. Valuation gains and losses are volatile from year to year, as both exchange rates and market interest rates fluctuate in wide ranges over time. Market risk is managed by the Bank within strict parameters determined by its responsibility for monetary policy.

The Reserve Bank reports net profit as income from all sources, in accordance with Australian Accounting Standards, while the distribution of profits is determined by section 30 of the Reserve Bank Act. In terms of the Reserve Bank Act, net profit is distributed in the following way:

- Unrealised gains (or losses) are not available for distribution and are transferred to (absorbed by) the unrealised profits reserve. The remainder of net profit after this transfer is available for distribution.
- The Treasurer then determines, after consultation with the Reserve Bank Board, any amounts to be placed from distributable earnings to the credit of the Reserve Bank Reserve Fund (RBRF), the Bank's permanent reserve.
- The remainder of distributable earnings after any transfer to the RBRF is payable as a dividend to the Commonwealth.

The composition of the Reserve Bank's net profit in 2016/17 is summarised in the table below.

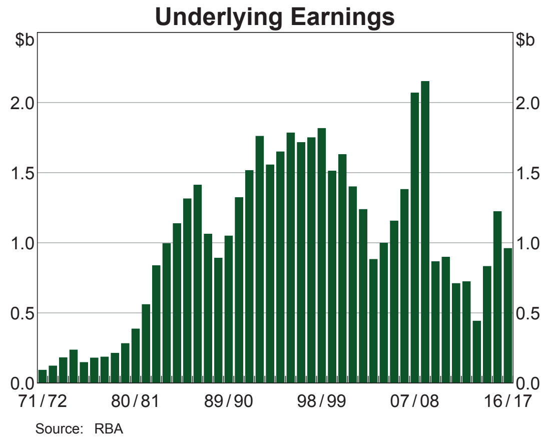
Reserve Bank Net Profit 2016/17
$ million

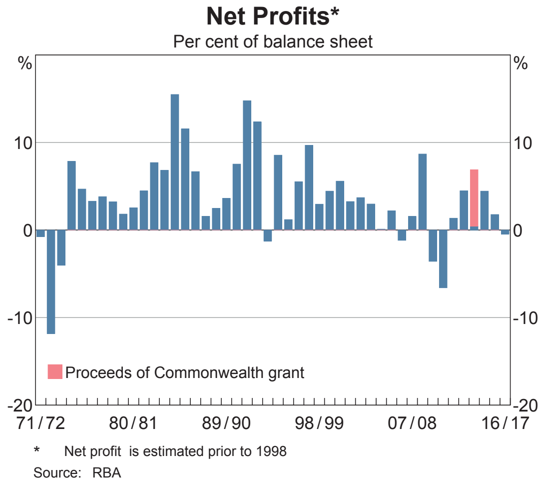
Underlying earnings	960
Net unrealised valuation loss (–)	–2 179
Net realised gain	322
Net loss	–897

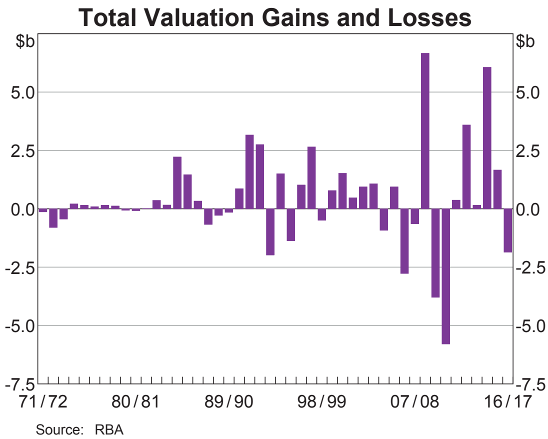
Source: RBA

In 2016/17, the Reserve Bank's underlying earnings were $960 million, which was $263 million lower than the previous year because of lower net interest income resulting from a decline in the net interest margin. The reduced interest margin reflected, in part, the decline in short-term interest rates in Australia compared with the previous year. Underlying earnings remained at historically low levels with interest rates around the world also typically remaining low.

The Reserve Bank's underlying earnings were offset by net valuation losses of $1 857 million, primarily from the appreciation of the Australian dollar during the year. The net valuation loss was composed of an unrealised valuation loss of $2 179 million offset by net realised gains of $322 million, largely as a result of the sale of foreign currency in the normal course of managing the portfolio of foreign reserves; these transactions had no effect on the value of the Australian dollar. The realised gains came from sales of assets on which unrealised gains had been recorded in earlier years, and therefore they acted to deplete the balance of the unrealised profits reserve, as discussed further below.







The net outcome was that the Reserve Bank recorded an accounting loss of $897 million, or 0.5 per cent of the balance sheet, in 2016/17. The pattern of net profit over the longer term is shown in the graph on net profits below.

Despite the accounting loss in 2016/17, earnings were still available for distribution, as the net unrealised valuation loss of $2 179 million was absorbed by the unrealised profits reserve in accordance with the Reserve Bank Act as explained above. This left earnings available for distribution amounting to $1 286 million in 2016/17, compared with $4 612 million in the previous year, reflecting both lower underlying earnings and smaller realised gains.

Capital, Reserves and Distribution

The RBRF is the Reserve Bank's general reserve and is the main component of the Bank's capital. The RBRF is funded from transfers from earnings available for distribution. Its purpose is to provide the capacity to absorb losses when it is necessary to do so.

The Reserve Bank Board has for many years had a policy of aiming to hold sufficient funds in the RBRF to absorb losses that might reasonably be anticipated from time to time. The RBRF served this purpose in 2009/10 and 2010/11 when the valuation losses from the large appreciation of the exchange rate in those years sharply depleted the Bank's reserves. These reserves have been restored over recent years, particularly as a result of a government grant in 2013/14.

During 2016/17, the Reserve Bank Board initiated a review of the capital framework to ensure that changes over time in the target balance in the RBRF appropriately reflected changes in the underlying risks faced by the Bank. The framework had previously required the same amount of capital to be held against all 'at risk' assets, regardless of their risk characteristics. This framework had been appropriate when the composition of the Bank's assets was relatively

Chair of the Reserve Bank Board Audit Committee John Akehurst (centre) observes as Governor Philip Lowe (third from left) signs the Reserve Bank's accounts for 2016/17 while the Auditor-General for Australia, Grant Hehir (second from right), signs his audit opinion; also present (from left) Reserve Bank Secretary Anthony Dickman, Assistant Governor (Corporate Services) Frank Campbell and Australian National Audit Office Group Executive Director Jocelyn Ashford

constant over time. However, over recent years, growth in the Bank's assets has been concentrated in low-risk, short-term domestic assets, rather than in higher-risk foreign exchange assets. As a result of the review, the Board has adopted a revised approach in which the Board's target for the RBRF is determined by assessing, and appropriately assigning capital to, exposures of different risk.

The largest potential for loss from the Reserve Bank's assets comes from market risk, comprising foreign exchange and interest rate risk. The capital assigned to each component of market risk has been derived from judgements based on the Bank's historical experience of loss and stress tests of the balance sheet, which incorporated significant adverse movements in the exchange rate and interest rates drawn from historical experience. Since the largest potential for loss is associated with the Bank's unhedged holdings of foreign exchange assets, materially more capital is assigned to exchange rate risk than to interest rate risk.

While the Reserve Bank has no history of loss from credit risk, credit risk has also been incorporated into the capital framework. In practice, the capital held against credit risk for assets held in the domestic portfolio and as part of international reserves is currently a small sum. This reflects the quality of assets the Bank holds, the soundness of counterparties with which it deals, the fact that repurchase agreements and foreign exchange swaps are well collateralised and that it follows a set of very conservative policies for managing credit risk, consistent with its very low appetite for such risk. Capital, therefore, is held only against the Bank's very small uncollateralised exposures to commercial banks. This overall approach to credit risk is consistent with the practice of a range of major central banks.

The Reserve Bank Board's capital framework will continue to be reviewed from time to time, including in response to developments that suggest the risk environment may be changing in material ways.

Based on the revised capital framework, the current balance in the RBRF met the Reserve Bank Board's target at the end of 2016/17. Accordingly, the Board views the balance sheet as being very strong and members saw no need to seek further capital from 2016/17 profits. The Treasurer, after consulting the Board, therefore determined that all earnings available for distribution in 2016/17, a sum of $1 286 million, would be paid as a dividend to the Commonwealth.

The balance of the unrealised profits reserve stood at $2 682 million on 30 June 2017, a decline of $2 179 million from the previous year. This movement reflects unrealised valuation losses associated with the appreciation of the Australian dollar, a rise in bond yields and the realisation of gains accumulated in earlier years. The remaining balance of the reserve is available either to absorb future valuation losses or to be distributed over time as the remaining accumulated gains are realised when relevant assets are sold.

Asset revaluation reserves are held for non-traded assets, such as gold holdings and property. Balances in these reserves represent the difference between the market value of these assets and the cost at which they were acquired. The total balance for these reserves was $4 721 million at 30 June 2017, $353 million lower than in the previous financial year, largely reflecting the decline in the Australian dollar value of the Reserve Bank's holdings of gold.

The balance of the superannuation reserve was $201 million at 30 June 2017.

Details of the composition and distribution of the Reserve Bank's profits are contained in the table on page 124.

The Financial Statements (and accompanying Notes to the Financial Statements) for the 2016/17 financial year were prepared in accordance with Australian Accounting Standards, consistent with the Finance Reporting Rule issued under the *Public Governance, Performance and Accountability Act 2013*.

Composition and Distribution of Reserve Bank Profits

($ million)

	Composition of Profits[(a)]				Distribution of Profits				Payments to Government		
					Transfer to/from(–)						
	Underlying earnings	Realised gains and losses(–)[(b)]	Unrealised gains and losses(–)	Accounting profit or loss(–)	Unrealised profits reserves	Asset revaluation reserves	Reserve Bank Reserve Fund	Dividend payable	Payment from previous year's profit	Payment delayed from previous year	Total payment
1997/98	1 750	966	1 687	4 403	1 687	–558	548	2 726	1 700	–	1 700
1998/99	1 816	2 283	–2 773	1 326	–2 349	–1	–	3 676	2 726	–	2 726
1999/00	1 511	–708	1 489	2 292	1 489	–	–	803	3 000	–	3 000
2000/01	1 629	1 200	320	3 149	320	–5	–	2 834	803	676	1 479
2001/02	1 400	479	–11	1 868	–11	–10	–	1 889	2 834	–	2 834
2002/03	1 238	1 157	–222	2 173	–222	–2	133	2 264	1 889	–	1 889
2003/04	882	–188	1 261	1 955	1 261	–	–	694	1 300	–	1 300
2004/05	997	366	–1 289	74	–1 289	–	–	1 363	374	964	1 338
2005/06	1 156	4	933	2 093	933	–17	–	1 177	1 063	320	1 383
2006/07	1 381	72	–2 846	–1 393	–2 475	–3	–	1 085	1 177	300	1 477
2007/08	2 068	614	–1 252	1 430	27	–	–	1 403	1 085	–	1 085
2008/09	2 150	4 404	2 252	8 806	2 252	–	577	5 977	1 403	–	1 403
2009/10	866	–128	–3 666	–2 928	–2 248	–	–680	–	5 227	–	5 227
2010/11	897	–1 135	–4 651	–4 889	–23	–	–4 866	–	–	750	750
2011/12	710	405	–39	1 076	–20	–	596	500	–	–	–
2012/13	723	–135	3 725	4 313	3 725	–	588	–	500	–	500
2013/14	9 242[(c)]	790	–640	9 392	–640	–3	8 800	1 235	–	–	–
2014/15	832	2 622	3 434	6 888	3 434	–	1 570	1 884	618	–	618
2015/16	1 223	3 389	–1 729	2 883	–1 729	–	1 390	3 222	1 884	618	2 501
2016/17	960	322	–2 179	–897	–2 179	–4	–	1 286	3 222	–	3 222

(a) As originally published
(b) Excludes gains or losses realised from the sale of fixed assets that had been held in asset revaluation reserves
(c) Includes the Commonwealth grant of $8 800 million
Source: RBA

Pro Forma Business Accounts

The following set of accounts for the Reserve Bank's contestable business have been prepared in accordance with competitive neutrality guidelines. These accounts do not form part of the audited financial statements.

Transactional Banking

	2015/16 $ million	2016/17 $ million
Revenue		
– Service fees	99.8	105.7
– Other revenue	3.8	3.5
Total	103.6	109.2
Expenditure		
– Direct costs	95.3	104.9
– Indirect costs	0.0	0.0
Total	95.3	104.9
Net profit/(loss)	8.3	4.3
Net profit/(loss) after taxes[a]	6.0	3.4
Assets[b]		
– Domestic markets investments	1 573.7	1 354.8
– Other assets	34.8	39.8
Total	1 608.5	1 394.6
Liabilities[b]		
– Capital & reserves	25.0	25.0
– Deposits	1 565.2	1 351.2
– Other liabilities	18.3	18.4
Total	1 608.5	1 394.6

(a) In accordance with competitive neutrality guidelines, income tax expense has been calculated and transferred to the Commonwealth as a notional part of the Reserve Bank's annual profit distribution
(b) As at 30 June
Source: RBA

Annual Performance Statement for 2016/17

I, as the accountable authority of the Reserve Bank of Australia, present the annual performance statement of the Reserve Bank for the 2016/17 reporting period, prepared under paragraph 39(1)(a) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). In my opinion, this annual performance statement accurately presents the performance of the Reserve Bank in the reporting period and complies with subsection 39(2) of the PGPA Act.

Philip Lowe
Governor, Reserve Bank of Australia
16 August 2017

Introduction

This performance statement outlines the key purposes of the Reserve Bank as set out in the 2016/17 corporate plan and provides the results of the measurement and assessment of the Bank's performance in achieving those purposes for the year ended 30 June 2017. Where necessary, additional context is provided, including an analysis of the significant factors that have contributed to the performance of the Bank in achieving its purposes in 2016/17.

As noted elsewhere in this annual report, the Reserve Bank of Australia is Australia's central bank and it conducts central banking business. The Bank has two boards, the Reserve Bank Board and the Payments System Board. The Reserve Bank Board is responsible for the Bank's monetary and banking policy and the Bank's policy on all other matters, except for payments system policy, for which the Payments System Board is responsible.

Monetary Policy

Purpose

Under the *Reserve Bank Act 1959*, it is the duty of the Reserve Bank Board to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank are exercised in a way that, in the Board's opinion, will best contribute to:

(a) the stability of the currency of Australia;

(b) the maintenance of full employment in Australia; and

(c) the economic prosperity and welfare of the people of Australia.

In support of the above duties, the *Statement on the Conduct of Monetary Policy* agreed by the Treasurer and the Governor confirms the Bank's continuing commitment to keeping consumer price inflation between 2 and 3 per cent, on average, consistent with its duties under the Reserve Bank Act.

Reserve Bank of Australia – Performance Summary 2016/17

Corporate Plan Purpose[(a)]	Summary Performance Measures	Results
Monetary policy		
Achieve inflation target	Consumer price inflation maintained between 2–3 per cent, on average, over the medium term	Consumer price inflation is forecast to be between 2 and 3 per cent over much of the forecast period; see the Bank's quarterly *Statement on Monetary Policy* for details. Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period
Financial stability		
Support overall financial stability	Stability of the financial system as it performs its function of supporting the economy	The financial system was assessed as remaining stable on the basis of a range of economic and financial data in 2016/17, although domestic vulnerabilities related to household debt and the housing market more generally have increased; see the Bank's semiannual *Financial Stability Review* for details. The Bank continued to work with the Council of Financial Regulators to identify and address evolving systemic risks
Financial market operations		
Achieve cash rate target	Overnight cash rate equal to target	The overnight cash rate was equal to target on all business days in 2016/17
Manage reserves to portfolio benchmarks	Portfolio managed within small deviations around the asset and duration benchmarks	Deviations from benchmark were small and in line with pre-defined limits
Payments & infrastructure		
Promote competition and efficiency in the payments system	Effect of new card standards	New standards are well understood and have resulted in declines in some surcharges (see *Payments System Board Annual Report 2017* for further detail)
Stability in the provision of financial market infrastructure (FMI) services	Assessment of Reserve Bank Information and Transfer System (RITS) and licensed clearing and settlement facilities against relevant standards	All entities were assessed as meeting relevant standards
	Contribute actively to international policy work on central counterparty resilience and FMI crisis management	The Bank continues to actively participate in this work
	Adapt domestic regulatory standards in response to international developments	Ongoing review; no change was required in 2016/17
RITS operational reliability	RITS availability of at least 99.95 per cent during core hours	RITS availability was 99.99 per cent during core hours in 2016/17
RITS cyber security	Cyber resilience of RITS	The Bank's ongoing program of cyber resilience work helped underpin the reliable operation of RITS in 2016/17

Reserve Bank of Australia – Performance Summary 2016/17

Corporate Plan Purpose[a]	Summary Performance Measures	Results
Banking		
Maintain transactional banking competitiveness	Minimum required return on capital equivalent to 10-year Australian Government Security rate plus a margin for risk	The Bank's banking services achieved the minimum required return on capital in 2016/17
Progress on projects to deliver convenient, secure, reliable and cost-effective banking services to customers	Progress on renovating the Bank's banking applications and systems	In 2016/17, the Bank completed, as planned, the renovation of key components of the systems that process bulk electronic payments and the final components of systems that collect payments for government Work continued on replacing the Bank's core account maintenance system, and remains on track for completion in late 2018 as planned. Work on the Bank's capability to participate in the New Payments Platform proceeded as planned in step with the payments industry's schedule
Banknotes		
Maintain public confidence in banknotes by:	Surveyed perceptions of Australian banknotes	The 2017 survey results showed heightened awareness of banknote security features and risk of counterfeiting
Meeting banknote demand	99.5 per cent of banknote orders from commercial banks fulfilled by the Bank on the day requested	100 per cent of orders were fulfilled on the day requested in 2016/17
Increasing security of Australian banknotes	Issuance under Next Generation Banknote program	The new $5 banknote was released on 1 September 2016 as planned and achieved wide acceptance and distribution.
	Counterfeiting rates	The counterfeiting rate in Australia remained low by international standards at 17 parts per million in 2016/17
Ensuring high-quality banknotes	Reserve Bank banknote production orders to be met by Note Printing Australia	All orders were met in full, on time and to the required quality standard in 2016/17
	Quality of banknotes in circulation	The quality in circulation increased by 5 per cent in 2016/17
Financial position & capital		
Maintain sufficient level of capital	Balance of the Reserve Bank Reserve Fund maintained in line with the Reserve Bank Board's policy	Achieved. See the section below on 'Financial Position and Capital' for details of changes to the framework for the Bank's capital during 2016/17

(a) See the Reserve Bank of Australia Corporate Plan 2016/17
Source: RBA

Ensuring low and stable inflation preserves the value of money and facilitates strong and sustainable growth in the economy over the longer term. Low inflation assists businesses and households in making sound investment decisions and underpins the creation of jobs, protects the savings of Australians and preserves the purchasing power of money. The *Statement on the Conduct of Monetary Policy* also recognises the importance of financial stability for a stable macroeconomic environment. Following the appointment of Philip Lowe as Governor of the Reserve Bank with effect from 18 September 2016, the *Statement on the Conduct of Monetary Policy* was revised to further clarify that it is appropriate for the Reserve Bank Board to take account of financial stability considerations in setting monetary policy. This revision has not affected how the Bank's performance in relation to monetary policy has been assessed, as set out below.

Results

Assessing the conduct of monetary policy by the Reserve Bank during 2016/17 involves judging whether the policy decisions taken by the Reserve Bank Board, based on the information available at the time, were consistent with achieving the inflation target of between 2 and 3 per cent, on average, to foster sustainable economic growth in Australia. Because there are lags between changes in the cash rate and their effect on the economy, such an assessment needs to give weight to both actual outcomes and the forecasts for inflation, output and the unemployment rate. These forecasts are published quarterly in the *Statement on Monetary Policy*.

Towards the end of 2016, the Reserve Bank Board undertook a review of the forecasts and monetary policy decisions it had taken since 2011, including the reasons behind the forecast misses and what the Bank's staff had learnt about the economy as a result. The review concluded that, based on the information available at the time the decisions were made, the Board had struck a reasonable balance in achieving its broad objectives in relation to the inflation target and financial stability considerations over the preceding several years.

GDP growth in 2016/17 is likely to have been lower than expected one year ago. This is partly attributable to the temporary effect of unseasonably bad weather. However, as outlined in the August 2017 *Statement on Monetary Policy*, the economy is expected to grow by 2½–3½ per cent over 2017/18, with growth expected to remain a bit above potential throughout the rest of the forecast period. Consumer price inflation is expected to be between 2 and 3 per cent over much of the 2½ year forecast period. This is consistent with the medium-term inflation target. Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period, which commenced in the early 1990s.

Since lowering the cash rate by 25 basis points in August 2016, the Reserve Bank Board has left the cash rate unchanged. The Board judged that this was consistent with achieving sustainable growth in the economy and inflation consistent with the target over the medium term. Within the context of a medium-term inflation target, it is appropriate that the Board pays attention to the resilience of the economy to future shocks. In light of this, the Board has been carefully monitoring developments in the labour market and growth in household debt, which may affect the economy's susceptibility to future shocks.

Analysis

On the global economy, the incoming data and the outlook for economic growth have improved compared with a year ago. Consistent with this, monetary policy has been tightened in the United States while expectations of further monetary easing in other advanced economies have diminished. However, global interest rates remain extremely low, measures of underlying inflation are generally subdued and potential growth is lower than in previous decades. Because Australia is a small open economy with a floating exchange rate, the environment of highly accommodative global monetary conditions has some effect on the way monetary policy is conducted in Australia.

Internal assessments suggest that the performance of the forecasts presented to the Reserve Bank Board has not been noticeably different from earlier years. The period of adjustment that has followed the end of the mining investment boom appears to be well advanced, as had been forecast, and non-mining activity has continued to pick up. Confidence has increased in the expectation that inflation will increase gradually over the period ahead, although this will depend on ongoing improvements in the labour market leading to a pick-up in wage growth.

Over the past year, the Reserve Bank Board has been considering the balance between achieving a more rapid pick-up in inflation than currently anticipated and the effect of lower interest rates on the resilience of households, given the increase in household debt. These deliberations have been supported by analytical work presented to the Board by Bank staff. The introduction of further regulatory measures to improve lending standards in 2017 is expected to mitigate some of the risks that have been building in household balance sheets. However, supporting spending in the economy today while avoiding creating vulnerabilities in household balance sheets, which could amplify the effects of future shocks, is difficult and complex.

The quarterly *Statement on Monetary Policy* provides further analysis by the Reserve Bank of the developments in the international and domestic economy and financial markets relevant to monetary policy, as do speeches by the Governor and other senior Bank officials and the monthly statements and minutes following the monetary policy meetings of the Reserve Bank Board.

Financial Stability

Purpose

Given the serious damage to employment and economic prosperity that can result from financial instability, the Reserve Bank Act has long implied a mandate to pursue financial stability. This goal has been made more explicit by successive governments. Most recently, the Treasurer and the Governor recorded their common understanding of the Bank's longstanding responsibility for financial system stability as part of the periodically updated *Statement on the Conduct of Monetary Policy*.

The Reserve Bank works with other regulatory bodies in Australia to foster financial stability. The Governor chairs the Council of Financial Regulators (CFR) – comprising the Bank, the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the Australian Treasury – whose role is to contribute to the efficiency and effectiveness of regulation and the stability of the financial system. The Bank's central position in the financial system – and its position as the ultimate provider of liquidity to the system – gives it a key role in financial crisis management, in conjunction with the other members of the CFR.

Results

The ultimate measure of performance in financial stability policy remains the stability of the financial system itself as it performs its function of supporting the economy. The Reserve Bank assesses a range of economic and financial data to help gauge the soundness of the financial system and potential vulnerabilities. As noted in the October 2016 and April 2017 issues of the Bank's half-yearly *Financial Stability Review*, domestic vulnerabilities related to household debt and the housing market more generally continued to be a focus during the past year, as well as risks related to commercial property lending and ongoing concerns associated with economic challenges in regions with large exposures to the resources sector. Tighter lending standards by authorised deposit-taking institutions, in part induced by regulatory actions by APRA and ASIC, have assisted in enhancing resilience to potential risks, and none of the domestic risks on their own appears to be enough to be a direct source of domestic financial instability in the near term.

The Reserve Bank uses its powers, influence and public communications to ensure as far as possible that the Australian financial system remains stable. During 2016/17, the Bank highlighted the key issues and risks for the Australian financial system in its *Financial Stability Review*, as well as in various public speeches. The Bank contributed to work with other CFR agencies during the year in the areas of: developments and risks in the housing and mortgage markets; financial technology (fintech); Australia's shadow banking sector; and crisis management preparedness.

In 2016/17, the Bank also contributed to work undertaken in relation to financial stability under the auspices of various international regulatory bodies, including the Financial Stability Board (FSB), the Basel Committee on Banking Supervision and the Trans-Tasman Council on Banking Supervision. The Governor participated as a member of the FSB Plenary (the decision-making body of the FSB), Steering Committee and Standing Committee on Assessment of Vulnerabilities. Other Bank staff participated as members of various committees and working groups. For further information, see the chapter on 'International Financial Cooperation' in this annual report.

Analysis

Financial stability in Australia has been assisted by the sustained strong financial performance of the domestic banking system. Australian banks have improved their resilience to future financial and economic shocks by increasing their capital ratios over recent years and are working to maintain prudent lending standards, particularly for their mortgage business. As noted above, the Reserve Bank, together with other CFR agencies, has been closely monitoring developments in residential mortgage lending and household balance sheets. Both APRA and ASIC have taken measures to address risks in this area and the CFR would consider further measures if necessary. Further relevant analysis by the Reserve Bank is provided in the *Financial Stability Review* and speeches by the Governor and other senior Bank officials.

Financial Market Operations

Purpose

The Reserve Bank has a sizeable balance sheet, which is managed in support of the Bank's policy objectives. Part of the balance sheet is used to ensure that there is sufficient liquidity in the domestic money market on a daily basis. This promotes the stable functioning of the financial system, in particular the payments system, and the objectives of monetary policy. The Bank's regular transactions in the foreign exchange market are conducted to manage Australia's foreign currency reserves, which are held on the balance sheet of the Bank, and also to provide foreign exchange services to the Bank's clients, the largest of which is the Australian Government. On occasion, the

Bank may intervene in the foreign exchange market, consistent with the objectives of monetary policy.

Results

The Reserve Bank's operations in financial markets support its monetary policy objectives through ensuring that the operational target in the domestic money market is met; this target (the cash rate target) is a decision of the Reserve Bank Board. When supplying liquidity to the domestic money market, the Bank seeks to ensure that the overnight cash rate is maintained at the prevailing cash rate target each day. The Bank collects information on each participant's activity in the money market and publishes the resulting measure of the overnight cash rate daily. The cash rate was equal to the target every day during 2016/17.

The Bank manages its foreign reserves portfolio relative to a benchmark. During 2016/17, the portfolio was managed so that any deviations around the benchmarks for exchange rate and interest rate risk were small and in line with pre-defined limits.

Analysis

The nature of the Reserve Bank's financial markets operations continues to be influenced by the diverging monetary policy trends among the major central banks, as well as the regulatory regimes that apply to financial markets in which the Bank transacts and/or the counterparties with which it deals, both domestically and internationally. During 2016/17, the Bank continued to monitor, and where necessary adjust to, the environment where regulations are undergoing a period of substantial reform and market functioning and structure are evolving significantly. The historically low level of global interest rates provided challenges for the Bank in managing its holdings of foreign reserves.

Payments and Infrastructure

Purpose

There are several distinct aspects to the Reserve Bank's role in the payments system, involving those of policymaker, overseer and supervisor, and owner and operator of key national payments infrastructure.

In relation to the policymaking role, it is the duty of the Payments System Board to ensure that the Bank's payments system policy is directed to the greatest advantage of the people of Australia, to ensure that the powers of the Bank under the *Payment Systems (Regulation) Act 1998* and the *Payment Systems and Netting Act 1998* are exercised in a way that, in the Payments System Board's opinion, will best contribute to:

(a) controlling risk in the financial system;

(b) promoting the efficiency of the payments system; and

(c) promoting competition in the market for payment services, consistent with the overall stability of the financial system.

In addition, it is the Payments System Board's duty to ensure that the powers and functions of the Bank under Part 7.3 of the *Corporations Act 2001* are exercised in a way that, in the Board's opinion, will best contribute to the overall stability of the financial system. These powers and functions relate to the supervision of central counterparties (CCPs) and securities settlement facilities, which are key components of the central infrastructure that supports financial markets. The Bank's payments policy area also acts as overseer of Australia's high-value payment system, RITS, which is another key part of Australia's financial market infrastructure.

The Reserve Bank's operational role in the payments system is effected through its ownership and management of RITS, which is used by banks and other approved financial institutions to settle their payment obligations on a real-time, gross settlement basis. Extinguishing settlement obligations in a safe and efficient manner ensures that there is no build-up of settlement obligations associated with high-value transactions and thereby promotes the stability of Australia's financial system.

Results

In May 2016, the Payments System Board determined three new standards relating to card payments, which will contribute to a more efficient and competitive payments system. As is discussed further in the *Payments System Board Annual Report 2017*, the new surcharging framework became effective for large merchants on 1 September 2016. A number of merchants, the most prominent being the major domestic airlines, implemented changes to their surcharging policies that resulted in significant falls in surcharges payable on typical airfares. Reflecting significant outreach from the Australian Competition and Consumer Commission and the Reserve Bank, the new framework was well understood. The new interchange standards became fully effective on 1 July 2017.

In support of the Payments System Board's responsibility to promote efficiency in the payments system, the Reserve Bank continues to contribute to the industry project to deliver the New Payments Platform (NPP), which will provide infrastructure that facilitates real-time, data-rich, easily addressed payments on a 24/7 basis for households, businesses and government entities. In 2016/17, the Bank completed the development of the Fast Settlement Service (FSS), which will provide real-time settlement of NPP transactions. This is a major project for the Reserve Bank and the completion of the internal build and test phase has been delivered on time and within budget. The FSS is now operating in test mode as part of broader industry testing of NPP-related infrastructure. The NPP is expected to commence operations around the end of 2017.

The Reserve Bank published annual assessments of each of the licensed clearing and settlement facilities as part of its ongoing oversight of these facilities. Assessments were published of the ASX clearing and settlement facilities in September 2016; of LCH.Clearnet Limited's SwapClear service in December 2016; and of Chicago Mercantile Exchange Inc. in March 2017. In these assessments, the Bank judged that all the entities had met the relevant standards and set out a series of regulatory priorities for the facilities for the subsequent year. The Bank's 2017 assessment of RITS against the *Principles for Financial Market Infrastructures*, which was published in May 2017, concluded that RITS observed all of the relevant principles.

In support of the Reserve Bank's oversight approach and of its policy framework, Bank staff also actively participated in international policy development and implementation monitoring related to CCP resilience and crisis management of financial market infrastructures. No change was required to domestic regulatory standards in 2016/17 as a result of international developments.

As the owner and operator of RITS, the Reserve Bank seeks to ensure that this system operates with extremely high levels of reliability and security, while also adapting to the needs of a 24/7 payments world. A broad range of operational metrics were tracked in real time during 2016/17, including measures of system liquidity, participants' transaction values and volumes, and system throughput and performance. The system availability target is 99.95 per cent for RITS during core system hours. The Bank exceeded this target during 2016/17, with system availability of 99.99 per cent achieved in core system hours.

The Reserve Bank is committed to ensuring that RITS is well protected from cyber attack and has an ongoing program of work aimed at ensuring very high levels of cyber resilience. In 2016/17, this work included monitoring of likely threats, penetration testing and enhancements to information technology infrastructure and controls.

Analysis

The Reserve Bank's work in the payments area in 2016/17 occurred in an environment that was continuing to change rapidly, with higher expectations of users and the industry concerning the speed of payments and the capacity to combine information with payments. Use of cash and cheques is declining relative to other payment instruments, while use of cards and other electronic forms of payment continues to grow strongly. New technologies, including distributed ledger technologies and other forms of fintech, have the potential to change the payments landscape and the operation of financial market infrastructures significantly. Bank staff liaise actively with the private sector to better understand trends in these areas and have participated in a range of domestic and international working groups with other regulators.

Banking

Purpose

Insofar as the Commonwealth requires it to do so, the Reserve Bank must act as banker for the Commonwealth. In common with many other central banks, the Bank also provides banking and custody services to a number of overseas central banks and official institutions. These services include payments and collections as well as general account maintenance and reporting.

Results

The Reserve Bank competes with other organisations to provide banking services to Australian Government agencies. It must cost and price these services separately from other activities as well as meet an externally prescribed minimum rate of return on capital over a business cycle. At present, this measure, equivalent to the 10-year Australian Government Security rate plus a margin for risk, is the Bank's principal measure of financial performance for its transactional banking business. In 2016/17, the Bank met the prescribed rate. Pro forma accounts for the transactional banking business are published in a separate chapter of this annual report.

During 2016/17, the Reserve Bank achieved progress in implementing several important banking projects, including the renovation of its banking applications and systems and building the capabilities to participate in the NPP. These projects have encountered the usual challenges associated with projects of large size and complexity, mostly around hiring and retaining appropriate staff. These challenges have been effectively handled. Key milestones were reached for the renovation of banking applications and systems, including completion of the work relating to the functionality used to process bulk electronic payments and the systems used to collect payments for the government. The effort to upgrade the Bank's core account maintenance system has commenced following the selection of a suitable provider and is ongoing. Building capability to participate in the NPP proceeded in step with the payments industry's schedule. The project involved working with other financial institutions to meet an industry-set deadline, and managing the usual challenges associated with coordinating with multiple stakeholders, each with their own business pressures and priorities.

Analysis

Substantial changes are under way in transactional banking, particularly in the area of payment services. The broader community is embracing technology and demanding digital services from all providers, including the government, at a rapid pace. During 2016/17, the Reserve Bank continued to ensure that it remained in a position to respond appropriately with convenient, secure, reliable and cost-effective services as the largest provider of transactional banking services to the Australian Government.

Banknotes

Purpose

The Reserve Bank is responsible for the issue, reissue and cancellation of Australian banknotes. Its primary purpose in carrying out this role is to maintain public confidence in the supply, security and quality of Australian banknotes. The Bank works with its wholly owned subsidiary, Note Printing Australia Limited (NPA), to design the banknotes and arranges for their production through NPA. The Bank distributes the banknotes to financial institutions, monitors and maintains their quality in circulation and withdraws unfit banknotes from circulation. It also monitors and analyses counterfeiting and carries out research into banknote security technology.

Results

The most recent Reserve Bank survey measuring public confidence in Australian banknotes was conducted in early 2017. The 2017 results showed that:

- Nine out of ten people have received a new $5 banknote.
- The main perceived reason for upgrading Australia's banknotes is security.
- There has been an increase in how often people check their banknotes following the introduction of the new $5 banknote, with 21 per cent checking banknotes at least regularly compared with 14 per cent in 2014.
- The perceived likelihood of receiving a counterfeit banknote was higher than in previous surveys, with 16 per cent stating they felt it was likely compared with 8 per cent in 2014.

During 2016/17, the Bank continued to monitor indicators that could affect the public's confidence in the supply, security and quality of Australian banknotes in circulation as described below.

Fulfilment of banknote orders by commercial banks provides an indication that the public's demand for banknotes is being met. As an indicator of meeting demand, the Reserve Bank aims to fulfil 99.5 per cent of banknote orders on the day requested; during 2016/17, 100 per cent of orders were fulfilled on the day requested.

The Reserve Bank's key initiative to enhance banknote security is the release of the new banknote series with upgraded security features. Work on the Next Generation Banknote program continued during 2016/17, with the new $5 banknote entering circulation on 1 September 2016 as planned. The Bank implemented a comprehensive communication strategy targeting both businesses and consumers to assist with public recognition of the new banknotes. The new $10 banknote is on track to enter circulation on 20 September 2017 as planned.

The Reserve Bank continued to monitor Australian banknote counterfeiting rates, which remained low by international standards. The estimated counterfeiting rate remained stable at 17 parts per million in 2016/17, after having risen over the preceding decade or so. The Bank also continued to monitor international developments in counterfeiting. This was aided by the Bank's engagement with overseas central banks and international organisations.

NPA met the Reserve Bank's orders for existing and new series banknotes in full, to the required quality standard and as per the agreed delivery schedule.

The quality of banknotes in circulation, as measured by the Reserve Bank in agreement with commercial banks, increased during 2016/17. This resulted from improvements in sorting processes, particularly for the $10 denomination. Across all denominations, quality improved by around 5 per cent based on the agreed measure.

Analysis

While the proportion of payments made using banknotes is declining relative to electronic payments, the number and value of banknotes on issue continues to rise, highlighting their continued importance as a store of value as well as a payment mechanism. Australia's level of counterfeiting remains low by international standards, although it has been tending to increase over time as advances in technology make it easier and cheaper to produce counterfeit banknotes.

Financial Position and Capital

Purpose

The Reserve Bank is not a profit-maximising institution. Profits are incidental to its policy outcomes. As noted in the above section on 'Financial Market Operations', the Bank holds assets primarily to conduct operations in financial markets to achieve its central banking policy objectives – specifically, to implement monetary policy, to support the Bank's role in the Australian foreign exchange market and to manage the country's international reserves. Although carried out largely for policy purposes, these activities have been profitable in most years in the past. The Bank seeks to ensure that its retained profits and other capital reserves are sufficient over time to absorb losses to which the Bank may be exposed.

Results

In 2016/17 the Reserve Bank Board reviewed the framework for the Reserve Bank's capital and decided to adopt an approach more reflective of the risks held on the Bank's balance sheet. Accordingly, the previous target for the Reserve Bank Reserve Fund (RBRF), of 15 per cent of assets at risk, was replaced with a target based on assigning capital charges to different classes of assets. These charges reflect an assessment of the respective risks of these assets, mainly foreign exchange and interest rate risk. The charge associated with credit risk is very small, reflecting the quality of assets the Bank holds, the common practice among central banks that capital not be held to cover sovereign and supranational exposures, and the rigorous framework for managing credit risk. The updated capital framework was derived from analysis of the Bank's historical experience and stress tests. Given this revised approach, the Reserve Bank Board assessed the balance in the RBRF, of $14 119 million, as appropriate for the risks the Bank faces. Accordingly, no transfer was made from profits to the RBRF in 2016/17.

Analysis

With the Reserve Bank's net foreign assets remaining largely unchanged (in foreign currency terms) at a level that is currently considered appropriate, and there being no material change in the Bank's exposures to interest rate risk, no transfer to the RBRF was sought from the Bank's earnings in 2016/17, as noted above. Consistent with section 30 of the Reserve Bank Act, the full sum of earnings available for distribution were therefore payable as a dividend to the Australian Government, the Bank's owner. More detail is provided in the chapter on 'Earnings, Distribution and Capital' in this annual report.

Statutory Reporting Requirements

The Reserve Bank has a number of statutory reporting requirements that extend beyond its policy objectives and cover areas such as equal employment opportunity, work health and safety and freedom of information requests submitted to the Bank. In 2016/17, the Bank's Diversity and Inclusion Program continued to focus on gender diversity, the Bank's culture of inclusiveness and flexible work practices, with a range of employee resource groups established to support these aims.

Equal Employment Opportunity

The Reserve Bank is strongly committed to ensuring that all employees are treated with respect and dignity, and experience equal opportunity throughout their careers with the Bank. This commitment is underpinned by a strong emphasis on embedding the Bank's values across all organisational practices and through its Diversity and Inclusion Plan. The Bank's policies and procedures seek to embed equity, diversity and inclusion principles in work practices. Its People and Culture Strategy and Diversity and Inclusion Plan outline key initiatives and priorities and are discussed further in the chapter on 'Our People'. A major focus in 2016/17 was the establishment of six Employee Resource Groups, which involve over 130 employees working together on issues related to accessibility, flexibility, gender equity, Indigenous Australians, LGBTI, and race and cultural identity.

The Diversity and Inclusion program is governed by the Executive Committee, in consultation with the recently formed Diversity and Inclusion Council, which is responsible for monitoring the development and implementation of diversity and inclusion initiatives, policies and practices in the Reserve Bank. Full details and outcomes of the 2016/17 Diversity and Inclusion Program are provided in the Bank's *Equity & Diversity Annual Report 2017*, which will be tabled in the Parliament in accordance with the requirement under the *Equal Employment Opportunity (Commonwealth Authorities) Act 1987*. The *Equity & Diversity Annual Report 2016*, which reported on the Bank's diversity profile and progress on the diversity program, was tabled in the Parliament on 13 October 2016.

Work Health and Safety, Compensation and Rehabilitation

The Reserve Bank is strongly committed to maintaining and improving the safety, health and wellbeing of its employees and workers. The Bank fosters a safety culture that focuses on the Bank's work health and safety (WHS) risk profile through preventative and proactive due diligence and practices. The Reserve Bank Board and the Bank's executive management receive regular reports on WHS matters to assist them in exercising their duty of care towards their workers.

During the year in review, a project on the Reserve Bank's WHS framework review was

The Reserve Bank is strongly committed to maintaining and improving the safety, health and wellbeing of its employees and workers

completed. This resulted in the development of some streamlined WHS management practices that are commensurate with the WHS risks the Bank faces. The Bank also developed a mental health strategy to support the prevention of workplace mental health issues, and provided ongoing training to management, workers and health and safety representatives on contemporary WHS matters.

The Reserve Bank implemented initiatives through the Health & Wellbeing Program to maximise the physical and psychological health of employees through promotion of positive health outcomes and prevention of potential health risks, including:

- physical health activities, such as fitness classes at Head Office, an annual health challenge, influenza vaccinations and health checks for senior managers and executives
- mental health initiatives, such as mental health and resilience training, access to the Bank's Employee Assistance Program and seminars on topics related to mental health and wellbeing.

There were 90 reported WHS incidents between 1 July 2016 and 30 June 2017. This was twice as many incidents as in the previous year, partly reflecting an expansion of the definition of what constitutes a reportable incident to include lift, security, fleet vehicle and visitor incidents, as well as an apparent increase in rates of reporting. Around 11 per cent of the incidents were sporting injuries sustained during breaks. There were six reported incidents that required notification to Comcare, a similar number as in the previous year. Accepted workers compensation claims remained low at three in 2016/17, with two relating to occupational overuse injuries and one involving a sporting injury sustained during a break. Overall, the Reserve Bank's Lost Time Injury Frequency Rate (number of lost time injuries per million hours worked) for 2016/17 was 0.9, compared with 1.0 in 2015/16, and consistent with the banking industry average. Six internal investigations relating to WHS matters were conducted by the Bank in 2016/17. No investigations were conducted by Comcare during 2016/17 that related to businesses or undertakings conducted by the Bank, and no improvement, prohibition or non-disturbance notices were issued to the Bank by Comcare under Part 10 of the *Work Health and Safety Act 2011* (WHS Act).

In terms of the WHS Act and the conditions of the Reserve Bank's licence as a Licensed Authority under the *Safety, Rehabilitation and Compensation Act 1988*, the Bank is required to report to the Safety, Rehabilitation and Compensation Commission each year on WHS and workers' compensation and rehabilitation

Summary of Notifiable Incidents, Investigations and Notices under the WHS Act

Action	2016/17	2015/16
Death of a person that required notice to Comcare under section 35	0	0
Serious injury or illness of a person that required notice to Comcare under section 35	1	2
Dangerous incident that required notice to Comcare under section 35	5	3
Internal Investigations conducted	6	1
Investigations conducted under Part 10	0	0
Notices given to RBA under section 90 (provisional improvement notices)	0	0
Notices given to RBA under section 191 (improvement notices)	0	0
Notices given to RBA under section 195 (prohibition notices)	0	0
Directions given to RBA under section 198 (non-disturbance notices)	0	0

Source: RBA

matters as they affect the Bank. Compliance with the relevant legislation – and the conditions of the Bank's licence as a Licensed Authority – was validated during the period by external audits of the Bank's safety, compensation and rehabilitation arrangements. The Safety, Rehabilitation and Compensation Commission subsequently confirmed that the Bank retained the highest rating (Tier 3) for its prevention, claims management and rehabilitation practices in each area for 2017/18.

During the year, the Reserve Bank applied to the Safety, Rehabilitation and Compensation Commission to vary its licence to permit the Bank to outsource its management of workers' compensation claims to the Australian Postal Corporation. This application was made because of the inherent difficulty and costs of maintaining sufficient capability to deal with (particularly complex) claims when the overall claims volume is low. The variation application was approved on 14 June 2017 and the Australian Postal Corporation is undertaking the role of managing workers' compensation claims on behalf of the Bank. The Bank nevertheless retains responsibility for workers' compensation under its licence.

Freedom of Information (FOI)

The Reserve Bank is an Australian Government agency subject to the *Freedom of Information Act 1982* (FOI Act). As required by Part II of the FOI Act, the Bank publishes information to the public as part of the Information Publication Scheme (IPS). Details of the Bank's obligations under the FOI Act and the IPS can be found on the Bank's website at <https://www.rba.gov.au/foi/index.html>.

Seventeen requests for access to documents under the FOI Act were received in 2016/17. Access was granted in full in relation to one request and in part in relation to five requests. No relevant documents were found in response to five requests. Access to documents was denied in response to one request and two requests were withdrawn. Three requests were outstanding at the end of the financial year. Information that was released in response to FOI access requests was published on the Reserve Bank's website, as required by the FOI Act, with RSS feeds to these releases also available.

Three applications were received for the internal review of FOI decisions made by the Reserve Bank in 2016/17. As required by the FOI Act, a fresh decision was taken in each instance, with the original decision being affirmed in the case of two applications and varied (with increased access) in the case of one application.

The estimated amount of staff time spent dealing with all aspects of FOI requests in 2016/17 was around 196 hours, compared with around 233 hours in 2015/16. The total cost to the Reserve Bank of administering the FOI Act in 2016/17 is estimated to have been about $61 200, compared with $59 900 in the previous year. No processing charges were levied in 2016/17 (no charges were received in 2015/16).

Ministerial Directions

The Reserve Bank received no new directions from its responsible Minister (the Treasurer) or from any other Minister during 2016/17.

No government policy orders under section 22 of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) were applied in relation to the Reserve Bank during 2016/17.

No issues relating to non-compliance by the Reserve Bank with finance law were reported to the Bank's responsible Minister (the Treasurer) under paragraph 19(1)(e) of the PGPA Act.

As one of the corporate Commonwealth entities 'prescribed' under section 30 of the Public Governance, Performance and Accountability Rule 2014, the Reserve Bank continues to be required to apply the Commonwealth Procurement Rules (CPRs) when performing duties relating to certain procurements.

The CPRs apply to the Reserve Bank whenever it undertakes a procurement where the expected value of the property or service being procured exceeds $400 000 for non-construction services or $7.5 million for construction services. For purchases of lower value, the Bank uses detailed guidelines based on the principles contained in the CPRs. The broad objective is to ensure that all goods and services procured by the Bank support its policy and operational responsibilities in an efficient and cost-effective manner.

Other Statutory Reporting Obligations

There were no significant activities or changes affecting the operations or structure of the Reserve Bank in 2016/17.

There were no judicial decisions or decisions of administrative tribunals made during 2016/17 that have had, or may have, a significant effect on the operations of the Reserve Bank.

Other statutory reporting obligations applying to the Reserve Bank that are covered elsewhere in this report are identified in the 'Statutory Reporting Requirements Index' on pages 189–190.

Part 4: Financial Statements

Financial Statements

For the year ended 30 June 2017

Statement of Assurance

In the opinion of each of the Governor, as the accountable authority of the Reserve Bank of Australia, and the Assistant Governor (Corporate Services), the financial statements for the year ended 30 June 2017 present fairly the Reserve Bank's financial position, financial performance and cash flows, comply with the accounting standards and any other requirements prescribed by the rules made under section 42 of the *Public Governance, Performance and Accountability Act 2013* and have been prepared from properly maintained financial records. These financial statements have been approved by a resolution of the Reserve Bank Board on 1 August 2017.

Philip Lowe
Governor and Chair, Reserve Bank Board

Frank Campbell
Assistant Governor (Corporate Services)

16 August 2017

Statement of Financial Position – as at 30 June 2017

Reserve Bank of Australia and Controlled Entity

	Note	2017 $M	2016 $M
Assets			
Cash and cash equivalents	6	221	367
Australian dollar investments	1(b), 15	104,769	88,500
Foreign currency investments	1(b), 15	83,577	72,879
Gold	1(d), 15	4,147	4,567
Property, plant and equipment	1(e), 8	741	640
Other assets	7	557	536
Total Assets		194,012	167,489
Liabilities			
Deposits	1(b), 9	92,669	61,210
Distribution payable to the Commonwealth	1(h), 3	1,286	3,222
Australian banknotes on issue	1(b)	73,623	70,209
Other liabilities	10	4,671	8,936
Total Liabilities		172,249	143,577
Net Assets		21,763	23,912
Capital and Reserves			
Reserves:			
Unrealised profits reserve	1(g)	2,682	4,861
Asset revaluation reserves	1(g), 5	4,721	5,074
Superannuation reserve	1(g)	201	(182)
Reserve Bank Reserve Fund	1(g)	14,119	14,119
Capital	1(g)	40	40
Total Capital and Reserves		21,763	23,912

The above statement should be read in conjunction with the accompanying Notes.

Statement of Comprehensive Income – for the year ended 30 June 2017

Reserve Bank of Australia and Controlled Entity

	Note	2017 $M	2016 $M
Net interest income	2	1,023	1,193
Fees and commission income	2	473	508
Other income	2	50	66
Net gains/(losses) on securities and foreign exchange	2	(1,857)	1,660
General administrative expenses	2	(406)	(405)
Other expenses	2	(180)	(139)
Net Profit/(Loss)		(897)	2,883
Gains/(losses) on items that may be reclassified to profit or loss:			
Gold		(420)	651
Shares in international and other institutions		(1)	14
		(421)	665
Gains/(losses) on items that will not be reclassified to profit or loss:			
Property		72	33
Superannuation		383	(316)
		455	(283)
Other Comprehensive Income		34	382
Total Comprehensive Income		(863)	3,265

The above statement should be read in conjunction with the accompanying Notes.

Statement of Distribution – for the year ended 30 June 2017

Reserve Bank of Australia and Controlled Entity

	Note	2017 $M	2016 $M
Net Profit/(Loss)		(897)	2,883
Transfer from unrealised profits reserve		2,179	1,729
Transfer from asset revaluation reserves		4	–
Earnings available for distribution		1,286	4,612
Distributed as follows:			
Transfer to Reserve Bank Reserve Fund		–	1,390
Payable to the Commonwealth	3	1,286	3,222
		1,286	4,612

The above statement should be read in conjunction with the accompanying Notes.

Statement of Changes in Capital and Reserves – for the year ended 30 June 2017

Reserve Bank of Australia and Controlled Entity

	Note	Unrealised profits reserve $M	Asset revaluation reserves $M	Superannuation reserve $M	Earnings available for distribution $M	Reserve Bank Reserve Fund $M	Capital $M	Total capital and reserves $M
Balance as at 30 June 2015		**6,590**	**4,376**	**134**	**–**	**12,729**	**40**	**23,869**
Net Profit/(Loss)	1(h)	(1,729)			4,612			2,883
Gains/(losses) on:								
Gold	1(d)		651					651
Shares in international and other institutions	1(b)		14					14
Property	1(e)		33					33
Superannuation	1(i)			(316)				(316)
Other comprehensive income			698	(316)				382
Total comprehensive income for 2015/16								**3,265**
Transfer to Reserve Bank Reserve Fund	1(g), 3				(1,390)	1,390		–
Transfer to distribution payable to the Commonwealth	1(h), 3				(3,222)			(3,222)
Balance as at 30 June 2016		**4,861**	**5,074**	**(182)**	**–**	**14,119**	**40**	**23,912**
Net Profit/(Loss)	1(h)	(2,179)			1,282			(897)
Gains/(losses) on:								
Gold	1(d)		(420)					(420)
Shares in international and other institutions	1(b)		(1)					(1)
Property	1(e)		72					72
Superannuation	1(i)			383				383
Other comprehensive income			(349)	383				34
Total comprehensive income for 2016/17								**(863)**
Transfer from Asset revaluation reserves	1(g), 3		(4)		4			–
Transfer to Reserve Bank Reserve Fund	1(g), 3					–		–
Transfer to distribution payable to the Commonwealth	1(h), 3				(1,286)			(1,286)
Balance as at 30 June 2017		**2,682**	**4,721**	**201**	**–**	**14,119**	**40**	**21,763**

The above statement should be read in conjunction with the accompanying Notes.

Cash Flow Statement – for the year ended 30 June 2017

Reserve Bank of Australia and Controlled Entity

For the purposes of this statement, cash includes the banknotes and coin held at the RBA and overnight settlement balances due from other banks.

	Note	2017 Inflow/ (outflow) $M	2016 Inflow/ (outflow) $M
Cash flows from operating activities			
Interest received		1,890	2,299
Interest paid		(1,054)	(1,095)
Net fee income received		381	423
Net payments for investments		(35,984)	(1,194)
Net cash collateral received/(pledged)		3,437	(3,002)
Other		(360)	(335)
Net cash used in operating activities	6	(31,690)	(2,904)
Cash flows from investment activities			
Net expenditure on property, plant and equipment		(69)	(93)
Net expenditure on computer software		(36)	(26)
Other		(2)	1
Net cash used in investment activities		(107)	(118)
Cash flows from financing activities			
Distribution to the Commonwealth	3	(3,222)	(2,501)
Net movement in deposit liabilities		31,459	724
Net movement in banknotes on issue		3,414	4,728
Net cash provided by financing activities		31,651	2,951
Net increase/(decrease) in cash		(146)	(71)
Cash at beginning of financial year		367	438
Cash at end of financial year	6	221	367

The above statement should be read in conjunction with the accompanying Notes.

Notes to and Forming Part of the Financial Statements – for the year ended 30 June 2017

Reserve Bank of Australia and Controlled Entity

Note 1 – Accounting Policies

The Reserve Bank of Australia (RBA) reports its consolidated financial statements in accordance with the *Reserve Bank Act 1959* and the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). These financial statements for the year ended 30 June 2017 are a general purpose financial report prepared under Australian Accounting Standards (AAS), other accounting standards and accounting interpretations issued by the Australian Accounting Standards Board, in accordance with the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015* (FRR), which is issued pursuant to the PGPA Act. The RBA is classified as a for-profit public sector entity for purposes of financial disclosure. These financial statements comply with International Financial Reporting Standards. In preparing them, the RBA has not 'early adopted' new accounting standards or amendments to current standards that apply from 1 July 2017.

All amounts in these financial statements are expressed in Australian dollars, the functional and presentational currency of the RBA. Fair values are used to measure the RBA's major assets, including Australian dollar and foreign securities, gold and foreign currency. Revenue and expenses are brought to account on an accruals basis. All revenues, expenses and profits of the RBA are from ordinary activities.

These financial statements were approved by a resolution of the Reserve Bank Board on 1 August 2017 in accordance with the Reserve Bank Act.

(a) Consolidation

The financial statements show information for the economic entity only; this reflects the consolidated results for the parent entity, the Reserve Bank of Australia, and its wholly owned subsidiary, Note Printing Australia Limited (NPA). The results of the parent entity do not differ materially from the economic entity and have therefore not been separately disclosed.

Note Printing Australia Limited

NPA was incorporated as a wholly owned subsidiary of the RBA on 1 July 1998, with an initial capital of $20 million. The RBA provided NPA with additional capital of $15 million in July 2008 and a further $25 million in July 2009.

NPA Balance Sheet	2017 $M	2016 $M
Assets	158.6	159.6
Liabilities	24.5	30.9
Equity	134.1	128.7

The assets, liabilities and results of NPA have been consolidated with the accounts of the parent entity in accordance with AASB 10 – *Consolidated Financial Statements*. All internal transactions and balances have been eliminated on consolidation. These transactions include items relating to the purchase of Australian banknotes, lease of premises and the provision of general administrative services.

(b) Financial instruments

A financial instrument is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The RBA accounts for its financial instruments in accordance with AASB 139 – *Financial Instruments: Recognition and Measurement* and reports these instruments under AASB 7 – *Financial Instruments: Disclosures* and AASB 13 – *Fair Value Measurement*. The RBA brings its securities transactions and foreign exchange transactions to account on a trade date basis. Deposits and repurchase agreements are brought to account on settlement date.

Financial assets

Australian dollar securities

The RBA holds on an outright basis Australian Government Securities and securities issued by the central borrowing authorities of state and territory governments.

Australian dollar securities, except those held under reverse repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are held to conduct monetary policy and may be sold or lent, typically for short terms, under repurchase agreements. The securities are valued at market bid prices on balance date; valuation gains or losses are taken to profit. Interest earned is accrued over the term of the security and included as revenue in the Statement of Comprehensive Income.

Repurchase agreements and reverse repurchase agreements

In carrying out operations to manage domestic liquidity and foreign reserves, the RBA enters into repurchase agreements and reverse repurchase agreements in Australian dollar and foreign currency securities. A repurchase agreement involves the sale of securities with an undertaking to repurchase them on an agreed future date at an agreed price. In a reverse repurchase agreement, securities are initially bought and this transaction is reversed at an agreed price on an agreed future date. As a reverse repurchase agreement provides the RBA's counterparties with cash for the term of the agreement, the RBA treats it as an asset by recording a cash receivable. Repurchase agreements result in cash being paid to the RBA and are treated as a liability, reflecting the obligation to repay cash.

Securities purchased and contracted for sale under reverse repurchase agreements are classified under AASB 139 as 'loans and receivables' and valued at amortised cost, the equivalent of fair value. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue.

RBA open repurchase agreements are provided to assist eligible financial institutions manage their liquidity after normal business hours. An RBA open repurchase agreement is an Australian dollar reverse repurchase agreement without an agreed maturity date. The RBA accrues interest daily on open repurchase agreements at the target cash rate.

Foreign government securities

Foreign government securities, except those held under reverse repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are available to be traded in managing the portfolio of foreign exchange reserves. These securities are valued at market bid prices on balance date and valuation gains or losses are taken to profit. Interest earned on securities is accrued as revenue in the Statement of Comprehensive Income.

Foreign deposits

Some foreign currency reserves are invested in deposits with the BIS and other central banks, while small working balances are also maintained with a small number of commercial banks. Deposits are classified as 'loans and receivables' under AASB 139 and recorded at face value, which is equivalent to their amortised cost using the effective interest method. Interest is accrued over the term of deposits.

Foreign currency swaps

The RBA uses foreign currency swaps with market counterparties both to assist daily domestic liquidity management and in managing foreign reserve assets. A foreign currency swap is the simultaneous purchase and sale of one currency against another currency for a specified maturity. The cash flows are the same as borrowing one currency for a certain period and lending another currency for the same period. The pricing of the swap therefore reflects the interest rates applicable to these money market transactions. Interest rates are implicit in the swap contract but interest itself is not paid or received. Foreign currency swaps are classified as 'at fair value through profit or loss' under AASB 139.

Interest rate futures

The RBA uses interest rate futures contracts on overseas exchanges to manage interest rate risk on its portfolio of foreign securities. An interest rate futures contract is a contract to buy or sell a specific amount of securities for a specific price on a specific future date.

Interest rate futures positions are classified under AASB 139 as 'at fair value through profit or loss'. Futures positions are marked to market on balance date and valuation gains and losses are taken to profit.

Asian Bond Fund

The RBA invests in a number of non-Japan Asian debt markets through participation in the EMEAP Asian Bond Fund. The RBA had modest holdings in the US dollar-denominated fund, ABF1, and the local currency-denominated fund, ABF2. EMEAP announced the closure of ABF1 in July 2016, with investments of member central banks, including the RBA, transferred to ABF2.

ABF2 is classified under AASB 139 as 'at fair value through profit or loss' and is valued on balance date at the relevant unit price of the fund, with valuation gains and losses taken to profit.

Bank for International Settlements

The RBA holds shares in the BIS. Shares in the BIS are owned exclusively by the central banks and monetary authorities that are its members. Under AASB 139, the RBA's shareholding in the BIS is classified as 'available for sale'. The shareholding is valued at fair value and revaluation gains and losses are transferred directly to the revaluation reserve for shares in international and other institutions (Note 5). The uncalled portion of this shareholding is disclosed as a contingent liability in Note 11. Dividends are recognised as revenue in the Statement of Comprehensive Income.

Financial liabilities

Deposit liabilities

Deposits held with the RBA are classified as financial liabilities under AASB 139. Deposits include both deposits 'at call' and term deposits. Deposit balances are shown at their amortised cost, which is equivalent to their face value. Interest is accrued over the term of deposits and is paid periodically or at maturity. Interest accrued but not paid is included in Other Liabilities (Note 10). Details of deposits are included in Note 9.

Australian banknotes on issue

Banknotes on issue are recorded at face value.

The RBA pays interest on working balances of banknotes held by banks under cash distribution arrangements. Details of the interest expense are included in Note 4.

Costs related to the production of banknotes are included in Other expenses in Note 2.

Repurchase agreements

Securities sold and contracted for repurchase under repurchase agreements are classified under AASB 139 as 'at fair value through profit or loss', as these securities are held for trading, and reported on the balance sheet within the relevant investment portfolio. The counterpart obligation to repurchase the securities is reported in Other Liabilities (Note 10) at amortised cost; the difference between the sale and purchase price is accrued over the term of the agreement and recognised as interest expense.

(c) Foreign exchange translation

Assets and liabilities denominated in foreign currency are converted to Australian dollar equivalents at the relevant market exchange rate on balance date in accordance with AASB 121 – *The Effects of Changes in Foreign Exchange Rates*. Valuation gains or losses on foreign currency are taken to profit. Interest revenue and expenses and revaluation gains and losses on foreign currency assets and liabilities are converted to Australian dollars using exchange rates on the date they are accrued or recognised.

(d) Gold

Gold holdings (including gold on loan to other institutions) are valued at the Australian dollar equivalent of the 3.00 pm fix in the London gold market on balance date. Revaluation gains and losses on gold are transferred to the asset revaluation reserve for gold.

The RBA lends gold to institutions that participate in the gold market. Gold provided under a loan is retained on the balance sheet. Interest is accrued over the term of the loan and is paid at maturity. The interest receivable on gold loans is accounted for in accordance with AASB 139.

(e) Property, plant and equipment

The RBA accounts for its property, plant and equipment in accordance with AASB 116 – *Property, Plant and Equipment* and AASB 13.

Property

The RBA measures its property at fair value. The RBA's Australian properties are formally valued annually by an independent valuer; overseas properties are independently valued on a triennial basis with the most recent valuation conducted for 30 June 2016. Reflecting their specialised nature, the RBA's Business Resumption Site and National Banknote Site are valued at depreciated replacement cost. Valuation gains (losses) are generally transferred to (from) the asset revaluation reserve. Any part of a valuation loss that exceeds the balance in the relevant asset revaluation reserve is expensed. Subsequent valuation gains that offset losses that were previously treated as an expense are recognised as revenue in the Statement of Comprehensive Income.

Annual depreciation is calculated on a straight line basis using assessments of the remaining useful life of the relevant building.

Plant and equipment

Plant and equipment is valued at cost less accumulated depreciation. Annual depreciation is calculated on a straight line basis using the RBA's assessments of the remaining useful life of individual assets.

Prior to 30 June 2017, the RBA measured plant and equipment at fair value. The change in accounting policy is consistent with AASB 116 and reflects the view that, compared with the fair value approach, cost provides a more reliable basis for measuring the value of the RBA's plant and equipment assets. The change has been applied prospectively as it does not materially affect the RBA's financial position (refer to Note 8).

Depreciation rates for each class of depreciable assets are based on the following range of useful lives:

	Years
Buildings	15–50
Fit-out	5–10
Computer hardware	4
Motor vehicles	5
Plant and other equipment	4–20

Assets are assessed for impairment at the end of each financial year. If indications of impairment are evident, the asset's recoverable amount is estimated and an impairment adjustment is made if the recoverable amount is less than the asset's carrying amount.

Annual net expenditure, revaluation adjustments and depreciation of buildings, plant and equipment are included in Note 8.

(f) Computer software

Computer software is treated in accordance with AASB 138 – *Intangible Assets*. Computer software is recognised at cost less accumulated amortisation and impairment adjustments, if any (refer to Note 7).

Amortisation of computer software is disclosed in Note 2 and is calculated on a straight line basis over the estimated useful life of the relevant asset, usually for a period of between four and six years. The useful life of payments settlements and core banking software may be for a period of between 10 and 15 years, reflecting the period over which future economic benefits are expected to be realised from these assets.

(g) Capital and reserves

The capital of the Reserve Bank is established by the Reserve Bank Act.

The Reserve Bank Reserve Fund (RBRF) is also established by the Reserve Bank Act and is regarded essentially as capital. The RBRF is a permanent reserve maintained to provide for events that are contingent and not foreseeable, including to cover losses from falls in the market value of the RBA's holdings of Australian dollar and foreign currency securities that cannot be absorbed by its other resources. The RBRF also provides for other risks such as fraud and operational risk. In accordance with the Reserve Bank Act, this reserve is funded only by transfers from net profits.

The Reserve Bank Board assesses the adequacy of the balance of the RBRF each year. During 2016/17, the Board initiated a review of its approach to measuring the adequacy of the balance of the RBRF and tied the target balance more directly to foreign exchange, interest rate and credit risk carried on the Bank's balance sheet. Further detail on this review is provided in the chapter on 'Earnings, Distribution and Capital'.

In line with section 30 of the Reserve Bank Act, the Treasurer, after consulting the Board, determines any amounts to be placed to the credit of the RBRF from net profit (refer Note 1(h)). The balance of the RBRF currently stands at a level that the Board regards as appropriate for the risks the RBA holds on its balance sheet.

The RBA also holds as equity a number of other reserves.

Unrealised gains and losses on foreign exchange, foreign securities and Australian dollar securities are recognised in net profit. Such gains or losses are not available for distribution and are transferred to the unrealised profits reserve, where they remain available to absorb future unrealised losses or become available for distribution if gains are realised when assets are sold or mature.

The balance of the Superannuation reserve represents accumulated remeasurement gains and losses on the RBA's defined benefit superannuation obligations (refer Note 1 (i)). These unrealised gains and losses are included in Other Comprehensive Income in accordance with AASB 119 – *Employee Benefits*.

Balances of asset revaluation reserves reflect differences between the fair value of non-traded assets and their cost. These assets are: gold; property; and shares in international and other institutions. Valuation gains are transferred directly to the relevant reserves and are included in Other Comprehensive Income; gains on these assets are not distributable unless an asset is sold and these gains are realised.

(h) Profits

Profits of the RBA are dealt with in the following terms by section 30 of the Reserve Bank Act:

(1) Subject to subsection (2), the net profits of the Bank in each year shall be dealt with as follows:

(aa) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines is to be set aside for contingencies; and

(a) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines shall be placed to the credit of the Reserve Bank Reserve Fund; and

(b) the remainder shall be paid to the Commonwealth.

(2) If the net profit of the Bank for a year is calculated on a basis that requires the inclusion of unrealised gains on assets during the year, the amount to which subsection (1) applies is to be worked out as follows:

(a) deduct from the net profit an amount equal to the total of all amounts of unrealised gains included in the net profit; and

(b) if an asset in respect of which unrealised gains were included in the net profit for a previous year or years is realised during the year – add to the amount remaining after applying paragraph (a) the total amount of those unrealised gains.

(i) Superannuation funds

The RBA includes in its Statement of Financial Position an asset or liability representing the position of its defined benefit superannuation funds measured in accordance with AASB 119. Movements in the superannuation asset or liability are reflected in the Statement of Comprehensive Income. Remeasurement gains and losses are transferred to the Superannuation reserve. Details of the superannuation funds and superannuation expenses are included in Note 14.

(j) Committed Liquidity Facility

The RBA provides a Committed Liquidity Facility (CLF) to eligible authorised deposit-taking institutions (ADIs). Fees received from providing the CLF are recognised as fee income in the Statement of Comprehensive Income. Additional information on the CLF is provided in Note 11.

(k) Rounding

Amounts in the financial statements are rounded to the nearest million dollars unless otherwise stated.

(l) Comparative information

Certain comparative information has been reclassified where required for consistency with the current year presentation.

(m) Application of new or revised Australian Accounting Standards

A number of new and revised AAS will apply to the RBA's financial statements in future reporting periods, as set out below. Application of these standards is not expected to have a material effect on the RBA's financial statements.

AASB 9 – Financial Instruments

The new standard, which will be applicable for annual reporting periods beginning on or after 1 January 2018, contains requirements for the classification, measurement and recognition of financial assets and liabilities. It will replace the corresponding requirements currently in AASB 139.

AASB 15 – Revenue from Contracts with Customers

AASB 15, which will be applicable for annual reporting periods beginning on or after 1 January 2018, contains requirements for the recognition, measurement, classification and disclosure of revenue arising from contracts with customers. It will replace corresponding requirements currently contained in AASB 118 – *Revenue* and AASB 111 – *Construction Contracts*.

AASB 16 – Leases

AASB 16 contains requirements for the recognition, measurement, classification and disclosure of leases for both lessee and lessors. The new standard, which will be applicable for annual reporting periods beginning on or after 1 January 2019, will replace corresponding requirements currently contained in AASB 117 – *Leases*.

Note 2 – Net Profit

	Note	2017 $M	2016 $M
Net interest income			
Interest income	1(b), 4	2,109	2,305
Interest expense	1(b), 4	(1,086)	(1,112)
		1,023	1,193
Fees and commissions income			
Committed Liquidity Facility	1(j)	347	390
Banking services		106	100
Payment services		20	18
		473	508
Other income			
Sales of note and security products		32	43
Rental of Bank premises		9	9
Dividend revenue	1(b)	5	4
Other		4	10
		50	66
Net gains/(losses) on securities and foreign exchange			
Foreign investments	1(b)	(169)	68
Australian dollar securities	1(b)	(400)	(229)
Foreign currency	1(b)	(1,288)	1,821
		(1,857)	1,660
General administrative expenses			
Staff costs		(218)	(215)
Net gains/(losses) on employee provisions		20	(34)
Superannuation costs	1(i)	(77)	(50)
Depreciation of property, plant and equipment	1(e), 8	(41)	(34)
Amortisation of computer software	1(f), 7	(10)	(5)
Premises and equipment		(61)	(50)
Other		(19)	(17)
		(406)	(405)
Other expenses			
Banking service fees		(89)	(81)
Materials used in note and security products		(49)	(25)
Banknote distribution		(2)	(3)
Other		(40)	(30)
		(180)	(139)
Net Profit/(Loss)		(897)	2,883

Note 3 – Distribution Payable to the Commonwealth

In terms of section 30 of the Reserve Bank Act, net profits of the RBA, less amounts set aside for contingencies or placed to the credit of the RBRF, are paid to the Commonwealth (see Note 1(h)). Also under section 30, unrealised profits from foreign exchange, foreign securities and Australian dollar securities are not available for distribution. Instead they are transferred to the unrealised profits reserve where they remain available to absorb future valuation losses or are realised when relevant assets are sold or mature. Unrealised losses are, in the first instance, absorbed within the unrealised profits reserve and are offset against unrealised profits accumulated from previous years. For purposes of distribution, if such losses exceed the balance of the unrealised profits reserve, the amount by which they do so is initially charged against other components of net profit, and any remaining loss is absorbed by the RBRF.

In 2016/17, the RBA recorded a net accounting loss of $897 million. Unrealised valuation losses amounted to $2,179 million and were absorbed by the balance of the unrealised profits reserve. In addition, a sum of $4 million, mainly reflecting accumulated valuation gains on the Bank's plant and equipment assets, was transferred from the asset revaluation reserve to the Statement of Distribution as part of an accounting policy change for the measurement of such assets (see Note 1(e)). Earnings available for distribution therefore amounted to $1,286 million in 2016/17. As the Board regarded the balance of the RBRF as appropriate for the risks held on the balance sheet, it recommended that no transfer to this reserve be made from net profit in 2016/17. Accordingly, the Treasurer, after consulting the Board, determined that the full sum of earnings available for distribution be paid as a dividend to the Commonwealth. An amount of $3,222 million from earnings in 2015/16 was paid to the Commonwealth in 2016/17.

	2017 $M	2016 $M
Opening balance	3,222	2,501
Distribution to the Commonwealth	(3,222)	(2,501)
Transfer from Statement of Distribution	1,286	3,222
As at 30 June	1,286	3,222

Note 4 – Interest Income and Interest Expense

Analysis for the year ended 30 June 2017

	Average balance $M	Interest $M	Average annual interest rate Per cent
Interest income			
Foreign currency investments	67,407	190	0.3
Australian dollar investments	91,644	1,906	2.1
Overnight settlements	371	5	1.3
Cash collateral provided	409	6	1.6
Gold loans	384	1	0.2
Loans, advances and other	30	1	1.6
	160,245	2,109	1.3
Interest expense			
Exchange Settlement balances	25,588	384	1.5
Deposits from governments	36,407	613	1.7
Deposits from overseas institutions	2,488	33	1.3
Banknote holdings of banks	3,252	41	1.3
Foreign currency repurchase agreements	1,968	7	0.3
Australian dollar repurchase agreements	95	1	1.4
Cash collateral received	442	7	1.5
Other deposits	14	–	0.4
	70,254	1,086	1.5
Net interest income	89,991	1,023	1.1
Analysis for the year ended 30 June 2016			
Interest income	150,288	2,305	1.5
Interest expense	61,596	1,112	1.8
Net interest income	88,692	1,193	1.3

Interest income for 2016/17 includes $1,376 million calculated using the effective interest method for financial assets not at fair value through profit or loss ($1,503 million in 2015/16). Interest expense for 2016/17 includes $1,086 million calculated using the effective interest method for financial liabilities not at fair value through profit or loss ($1,112 million in 2015/16).

Note 5 – Asset Revaluation Reserves

The composition of the RBA's asset revaluation reserves (Note 1(g)) is shown below.

	Note	2017 $M	2016 $M
Gold	1(d)	4,020	4,439
Shares in international and other institutions	1(b), 7	369	370
Property[(a)]	1(e), 8	332	265
As at 30 June		4,721	5,074

(a) The comparative includes a sum of $4 million in the asset revaluation reserve for plant and equipment. As noted in Note 1(e), the RBA has changed its accounting policy for the measurement of plant and equipment from fair value to cost, with effect 30 June 2017

Note 6 – Cash and Cash Equivalents

	2017 $M	2016 $M
Cash	42	31
Overnight settlements	179	336
As at 30 June	221	367

Reconciliation of net cash used in operating activities to Net Profit	Note	2017 $M	2016 $M
Net Profit/(Loss)		(897)	2,883
Increase/(decrease) in interest payable		23	11
Net loss/(gain) on overseas investments	2	169	(68)
Net loss/(gain) on Australian dollar securities	2	400	229
Net loss/(gain) on foreign currency	2	1,288	(1,821)
Decrease/(increase) in income accrued on investments		(210)	–
Cash collateral received/(pledged)		3,437	(3,002)
Depreciation of property, plant and equipment	2	41	34
Amortisation of computer software	2	10	5
Net payments for investments		(35,984)	(1,194)
Other		33	19
Net cash used in operating activities		(31,690)	(2,904)

Cash and cash equivalents include net amounts of $179 million owed to the RBA for overnight clearances of financial transactions through the payments system ($336 million at 30 June 2016). Other cash and cash equivalents include NPA's bank deposits.

Cash and cash equivalents exclude Australian and foreign short-term investments held to implement monetary policy or as part of Australia's foreign reserve assets. These investments are disclosed as Australian dollar investments and foreign currency investments, respectively; further detail is disclosed in Note 15.

Note 7 – Other Assets

	Note	2017 $M	2016 $M
Shareholding in Bank for International Settlements	1(b)	412	413
Computer software	1(f)	82	56
Other		63	67
As at 30 June		557	536

At 30 June 2017, the gross book value of the RBA's computer software amounted to $110.0 million and the accumulated amortisation on these assets was $27.9 million ($79.3 million and $23.1 million, respectively, at 30 June 2016). During 2016/17, there were $30.7 million in net additions to computer software ($26.1 million in 2015/16) and $10.1 million in amortisation expense ($4.6 million in 2015/16). The RBA had contractual commitments of $9.6 million as at 30 June 2017 for the acquisition of computer software ($1.1 million at 30 June 2016).

Other assets include receivables of $25.9 million as at 30 June 2017 ($24.9 million at 30 June 2016), none of which is impaired.

Note 8 – Property, Plant and Equipment

	Land and Buildings $M	Plant and Equipment $M	Total $M
Gross Book Value as at 30 June 2016	453	250	703
Accumulated depreciation	–	(63)	(63)
Net Book Value	453	187	640
Additions	37	35	72
Depreciation expense	(11)	(30)	(41)
Net gain/(loss) recognised in Net Profit	–	–	–
Net gain/(loss) recognised in Other Comprehensive Income	72	–	72
Disposals	–	(2)	(2)
Net additions to net book value	98	3	101
Gross Book Value as at 30 June 2017	552	296	848
Accumulated depreciation	(1)	(106)	(107)
Net Book Value	551	190	741

The net book value of the RBA's property, plant and equipment includes $29.0 million of work in progress ($83.4 million at 30 June 2016). The change in accounting policy for the measurement of the RBA's plant and equipment from fair value to cost (refer to Note 1(e)) resulted in a net reduction of $0.4 million in the net book value of plant and equipment at 30 June 2017.

As at 30 June 2017, the RBA had contractual commitments of $10.4 million for the acquisition or development of property, plant and equipment ($65.7 million at 30 June 2016), all of which are due within one year ($46.9 million at 30 June 2016).

Note 9 – Deposits

	2017 $M	2016 $M
Exchange Settlement balances	28,215	24,745
Australian Government	59,086	31,521
State governments	232	120
Foreign governments, foreign institutions and international organisations	5,126	4,810
Other depositors	10	14
As at 30 June	92,669	61,210

Note 10 – Other Liabilities

	Note	2017 $M	2016 $M
Provisions			
Provision for annual and other leave		21	19
Provision for long service leave		44	43
Provision for post-employment benefits		106	125
Other		–	1
		171	188
Other			
Securities sold under agreements to repurchase	1(b)	1,580	4,526
Payable for unsettled purchases of securities		1,533	1,809
Foreign currency swap liabilities	1(b), 15	1,150	1,861
Interest accrued on deposits		95	64
Superannuation liability	1(i), 14	55	397
Other		87	91
		4,500	8,748
Total Other Liabilities as at 30 June		4,671	8,936

The RBA's provision for its post-employment benefits was $18.9 million lower in 2016/17, largely due to an increase in the discount rate. Benefits of $4.6 million were paid out of the provision for post-employment benefits in 2016/17. The balance of the provision for post-employment benefits will change if assumptions about the length of staff service, the longevity of retired staff, future movements in medical costs or the discount rate vary.

Other provisions consist of $488,000 for workers compensation ($694,000 at 30 June 2016).

Note 11 – Contingent Assets and Liabilities

Committed Liquidity Facility

Since 1 January 2015, the RBA has provided a Committed Liquidity Facility (CLF) to eligible ADIs as part of Australia's implementation of the Basel III liquidity standards. The CLF provides ADIs with a contractual commitment to funding under repurchase agreements with the RBA, subject to certain conditions. It was established to ensure that ADIs are able to meet their liquidity requirements under Basel III. The CLF is made available to ADIs in Australia because the supply of high quality liquid assets (HQLA) is lower in Australia than is typical in other major countries; in other countries, these liquidity requirements are usually met by banks HQLAs on their balance sheet. While the RBA administers the CLF, the Australian Prudential Regulation Authority (APRA) determines which institutions have access to the facility and the limits available. Any drawdown must meet certain conditions, including: APRA does not object to the drawdown; and the RBA assesses that the ADI has positive net worth. Accordingly, the potential funding under the CLF is disclosed as a contingent liability; repurchase agreements associated with providing funding are disclosed as a contingent asset. If an ADI drew on the CLF, the funds drawn would be shown as a deposit liability of the RBA, and the counterpart repurchase agreement as an Australian dollar investment.

The aggregate undrawn commitment of the CLF at 30 June 2017 totalled about $193 billion for 14 ADIs (about $224 billion for 13 ADIs at 30 June 2016).

Bank for International Settlements

The RBA has a contingent liability, amounting to $65.1 million at 30 June 2017 ($67.7 million at 30 June 2016), for the uncalled portion of its shares held in the BIS.

NPA and Securency

Charges were laid in 2011 against NPA and Securency International Pty Ltd (Securency) alleging that the companies and a number of individuals conspired to provide or to offer to provide, at various times between December 1999 and September 2004, benefits to foreign public officials that were not legitimately due. A number of former employees of the companies were charged between 2011 and 2013 with engaging in the alleged conspiracies, with false accounting offences or with both. The RBA has accounted for the costs, and potential costs, to the consolidated entity related to these charges in accordance with AASB 137 – *Provisions, Contingent Liabilities and Contingent Assets*. Specific information about these charges and the associated costs have not been disclosed in the notes to the accounts as these matters remain before the courts. In light of several uncertainties, it is not possible to make reliable estimates of all of the potential costs associated with the charges, or potential claims in connection with them, at the date of preparing these accounts.

In February 2013, the RBA completed the sale of its 50 per cent interest in Securency (now known as CCL Secure Pty Ltd) to a related entity of Innovia Films, a UK-based film manufacturer, which had previously owned the other half of Securency. Under the sale agreement the RBA provided the owner of Securency with a number of indemnities in relation to the period during which Securency had been jointly owned by the RBA and Innovia Films. It is not possible to reliably estimate the potential financial effect of these indemnities. The RBA, however, does not consider it probable at this time that it will have to make payments in terms of these indemnities. Accordingly, the indemnities are treated as contingent liabilities in accordance with AASB 137.

In addition, an amount covering 50 per cent of certain potential liabilities of Securency relating to events prior to the sale was placed in escrow in February 2013. In 2016/17 the RBA contributed its agreed share from the escrow for one of those liabilities. The residual amount in escrow for that liability was released to the RBA during the financial year. In February 2020 the RBA will receive the balance then remaining in escrow after relevant claims have been paid, settled or lapse. Where it is not possible to estimate the likelihood of the RBA receiving any payments from amounts held in escrow, these amounts are treated as a contingent asset, in accordance with AASB 137.

Insurance

The RBA carries its own insurance risks except when external insurance cover is considered to be more cost-effective or is required by legislation.

Performance Guarantees

In the course of providing services to its customers, the RBA provides performance guarantees to third parties in relation to customer activities. Such exposure is not material and has not given rise to losses in the past.

Note 12 – Key Management Personnel

The key management personnel of the Reserve Bank are the Governor and Deputy Governor, non-executive members of the Reserve Bank Board, non-executive members of the Payments System Board and the Assistant Governors, who are the senior staff responsible for planning, directing and controlling the activities of the Bank. There were 20 of these positions in 2016/17, one fewer than in the previous year as the responsibilities of the Assistant Governor (Banking & Payments) were consolidated with those of another Assistant Governor, creating a single role as the Assistant Governor (Business Services) during 2015/16. A total of 25 individuals occupied these positions for all or part of the financial year, an increase from 22 in the previous year. This rise reflected the conclusion of the terms of, and the appointment of successors for, a number of occupants of positions in the group of key management personnel.

The positions of Governor and Deputy Governor are designated as Principal Executive Offices in terms of the *Remuneration Tribunal Act 1973*, which provides for the Remuneration Tribunal to determine the applicable remuneration for these positions. Within the parameters determined by the Remuneration Tribunal, the Reserve Bank Board Remuneration Committee, comprising three non-executive members, makes a recommendation on remuneration for these positions for the approval of the Board, which is the 'employing body' for the positions. In July 2017, the Remuneration Tribunal determined that, effective 1 July 2017, an adjustment of 2 per cent would be made to the remuneration of offices in its jurisdiction, including those of the Governor and Deputy Governor. Consistent with this, the Board resolved on 1 August 2017 to set the remuneration reference rate for the position of Governor at $1,020,000 (superannuable salary of $744,600) and that for the Deputy Governor at $765,000 (superannuable salary of $558,450). No performance payments were made to any individual while occupying these positions in 2016/17.

Fees for non-executive members of the Reserve Bank Board and the Payments System Board are determined by the Remuneration Tribunal. The Governor, in consultation with the Board, determines the rates of remuneration of Assistant Governors. For staff generally, remuneration aims to be market competitive and designed to attract and retain appropriately skilled people. Remuneration levels for employees are externally benchmarked.

The disclosure of key management personnel remuneration is based on AASB 124 – *Related Party Disclosures*, as shown below. The figures are disclosed on an accruals basis and show the full cost to the consolidated entity; they include all leave and fringe benefits tax charges.

	2017 $	2016 $
Short-term employee benefits	5,331,771	5,402,979
Post-employment benefits	884,655	1,013,006
Other long-term employee benefits	596,005	300,252
Termination benefits	–	–
Total compensation[(a)]	6,812,431	6,716,237

(a) Within the group of key management personnel, 23 individuals (20 in 2015/16) were remunerated and included in this table; the two key management personnel that are not remunerated are the Secretary to the Treasury, as a member of the Reserve Bank Board, and the Chairman of the Australian Prudential Regulation Authority, as a member of the Payments System Board

Short-term benefits include cash salary and, where relevant for executives, lump sum payments, motor vehicle benefits, car parking and health benefits and the fringe benefits tax paid or payable on these benefits. Post-employment benefits include superannuation benefits and, in the case of staff, health benefits. Other long-term employee benefits include long service leave and annual leave as well as the cost of (or gain on) revaluing previously accrued leave entitlements in accordance with AASB 119 (refer Note 10).

There were no loans during 2016/17 and 2015/16 by the RBA to any key management personnel.

There were no related party transactions with Board members or executives. Transactions with member-related entities that occurred in the normal course of the RBA's operations were incidental and conducted on terms no more favourable than similar transactions with other employees or customers; any vendor relationships with such entities were at arm's length and complied with the Bank's procurement policy.

Note 13 – Auditor's Remuneration

	2017 **$**	**2016** **$**
Fees paid or payable to the statutory auditor (Australian National Audit Office) for audit services	459,000	425,000

KPMG has been contracted by the Australian National Audit Office (ANAO) to provide audit services for the external audit of the RBA. This includes audit services for the RBA's subsidiary NPA and the Reserve Bank of Australia Officers' Superannuation Fund.

During 2016/17, KPMG earned additional fees of $80,069 for non-audit services that were separately contracted by the RBA ($184,698 in 2015/16). These fees are mainly included in General administrative expenses in Note 2.

Note 14 – Superannuation Funds

The RBA sponsors two superannuation funds: RB Super (formerly the Reserve Bank of Australia Officers' Superannuation Fund (OSF)) and the Reserve Bank of Australia UK Pension Scheme. The OSF Board of Trustees transferred the members and assets of the OSF to a multi-employer fund (MEF) via a successor fund transfer in March 2017. The Bank does not have a role in directly operating or governing RB Super; the Bank has no involvement in the appointment of the RB Super Trustees. Current and future benefits are funded by member and RBA contributions and the existing assets of these schemes. The RBA's superannuation expenses are included in net profit and shown in Note 2.

RB Super is a hybrid plan, with a mix of defined benefit members, defined contribution members and pensioners. Defined benefit members receive a defined benefit in accordance with RB Super's plan rules. All members have unitised accumulation balances, which comprise employer contributions and members' personal contributions plus earnings on contributions. Defined benefit membership was closed to new RBA staff from 1 August 2014. From that date, new staff have been offered defined contribution superannuation.

The UK Pension Scheme is a closed defined benefit scheme subject to relevant UK regulation.

Funding valuation

Independent actuarial valuations of RB Super and the UK Pension Scheme are conducted every three years.

The first triennial actuarial valuation for RB Super will be completed for the financial position as at 30 June 2017. The valuation for the OSF was last undertaken at 30 June 2014. The funding valuation of the OSF in 2014 was based on the Attained Age Funding method. Accrued benefits were determined as the value of the future benefits payable to members (allowing for future salary increases), discounted by the expected rate of return on assets held to fund these benefits. At the time of this review, the surplus of the OSF was $110.3 million. On the same valuation basis, the RB Super surplus as at 30 June 2017 amounted to $238.9 million. The RBA maintained its contribution rate to fund defined benefit obligations at 18.3 per cent of salaries in 2016/17, consistent with the actuary's recommendation.

The latest funding valuation for the UK Scheme was at 30 June 2016 and was also based on the Attained Age Funding method. At the time of this review, the UK Pension Scheme was in a small surplus. On this basis, the surplus at 30 June 2017 was $0.6 million, with assets of $25.2 million compared with accrued benefits of $24.6 million. The Trustees of the UK Scheme will keep its funding position under review.

Accounting valuation

For financial statement purposes, the financial positions of RB Super and the UK Pension Scheme are valued in accordance with AASB 119. This standard requires disclosures of significant actuarial assumptions, a maturity analysis of the defined benefit obligation and key risk exposures. Information is provided only for RB Super, as the UK Pension Scheme is not material. Prior year disclosures relate to RB Super's predecessor, the OSF.

Actuarial assumptions

The principal actuarial assumptions for the AASB 119 valuation of RB Super are:

	2017 Per cent	2016 Per cent
Discount rate (gross of tax)[(a)]	4.5	3.6
Future salary growth[(b)]	3.0	3.0
Future pension growth[(b)]	3.0	3.0

(a) Based on highly rated Australian dollar-denominated corporate bond yields
(b) Includes a short-term assumption of 2.0 per cent for the first four years of the projections (2.0 per cent for the first five years in 2016)

Maturity analysis

The weighted-average duration of the defined benefit obligation for RB Super is 19 years (21 years at 30 June 2016). The expected maturity profile for defined benefit obligations of RB Super is as follows:

	2017 Per cent	2016 Per cent
Less than 5 years	18	15
Between 5 and 10 years	16	14
Between 10 and 20 years	26	25
Between 20 and 30 years	19	20
Over 30 years	21	26
Total	100	100

Risk exposures

Key risks from the RBA's sponsorship of the RB Super defined benefit plan include investment, interest rate, longevity, salary and pension risks.

Investment risk is the risk that the actual future return on plan assets will be lower than the assumed rate.

Interest rate risk is the exposure of the defined benefit obligations to adverse movements in interest rates. A decrease in interest rates will increase the present value of these obligations.

Longevity risk is the risk that RB Super members live longer, on average, than actuarial estimates of life expectancy.

Salary risk is the risk that higher than assumed salary growth will increase the cost of providing a salary-related pension.

Pension risk is the risk that pensions increase at a faster rate than assumed, thereby increasing the cost of providing them.

The table below shows the estimated change in the defined benefit obligation resulting from movements in key actuarial assumptions. These estimates change each assumption individually, holding other factors constant; they do not incorporate any correlations among these factors.

	2017 $M	2016 $M
Change in defined benefit obligation from an increase of 0.25 percentage points in:		
Discount rate (gross of tax)	(62)	(76)
Future salary growth	16	21
Future pension growth	47	56
Change in defined benefit obligation from a decrease of 0.25 percentage points in:		
Discount rate (gross of tax)	66	82
Future salary growth	(15)	(20)
Future pension growth	(45)	(53)
Change in defined benefit obligation from an increase in life expectancy of one year	43	54

Asset distribution

The distribution of RB Super's assets used to fund members' defined benefits at 30 June is:

	Per cent of fund assets	
	2017	2016[(a)]
Cash and short-term securities	2	3
Fixed interest and indexed securities	10	15
Domestic equities	34	35
Foreign equities	24	17
Property	12	15
Private equity and infrastructure	18	15
Total	100	100

(a) Composition of assets held by the OSF

AASB 119 Reconciliation

The table below contains a reconciliation of the AASB 119 valuation of RB Super. The figures for 2016 are for the OSF, as are the opening balances in 2017. These details are for the defined benefit component only, as the RBA faces no actuarial risk on defined contribution balances and these balances have no effect on the measurement of the financial position of RB Super.

	2017 $M	2016 $M
Opening balances:		
Net market value of assets	991	967
Accrued benefits	(1,388)	(1,031)
Opening superannuation asset/(liability)	(397)	(64)
Change in net market value of assets	166	24
Change in accrued benefits	175	(357)
Change in superannuation asset/(liability)	341	(333)
Closing balances:		
Net market value of assets	1,157	991
Accrued benefits	(1,213)	(1,388)
Closing superannuation asset/(liability)	(56)	(397)
Interest income	35	47
Benefit payments	(45)	(42)
Return on plan assets	152	(6)
Contributions from RBA to defined benefit schemes	24	24
Change in net market value of assets	166	24
Current service cost	(53)	(37)
Interest cost	(49)	(50)
Benefit payments	45	42
Gains/(losses) from change in demographic assumptions	–	–
Gains/(losses) from change in financial assumptions	253	(312)
Gains/(losses) from change in other assumptions	(21)	1
Change in accrued benefits	175	(357)
Current service cost	53	37
Net Interest expense/(income)	13	4
Productivity and superannuation guarantee contributions	7	6
Superannuation expense/(income) included in profit or loss	73	47
Actuarial remeasurement loss/(gain)	(383)	316
Superannuation expense/(income) included in Statement of Comprehensive Income	(310)	363

The components of this table may not add due to rounding.

Note 15 – Financial Instruments and Risk

As the central bank in Australia, the RBA is responsible for implementing monetary policy and managing Australia's foreign reserve assets. Consequently, the RBA holds a range of financial assets, including government securities, repurchase agreements and foreign currency swaps. As to financial liabilities, the RBA issues Australia's banknotes and takes deposits from its customers, mainly the Australian Government, and eligible financial institutions. The RBA also provides banking services to its customers and operates Australia's high-value payments and interbank settlement systems.

Financial Risk

The RBA is exposed to a range of financial risks that reflect its policy and operational responsibilities. These risks include market risk, credit risk and liquidity risk. The chapters on 'Operations in Financial Markets' and 'Risk Management' provide information on the RBA's management of these financial risks. The RBA's approach to managing financial risk is set out in the Risk Appetite Statement available on the RBA website.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises foreign exchange risk and interest rate risk.

Foreign exchange risk

Foreign exchange risk is the risk that the fair value or cash flows of the RBA's foreign currency assets and liabilities will fluctuate because of movements in exchange rates. An appreciation in the Australian dollar results in valuation losses, while a depreciation leads to valuation gains. The overall level of foreign currency exposure is determined by policy considerations. The RBA's net foreign currency exposure as at 30 June 2017 was $51.8 billion ($53.3 billion as at 30 June 2016). Within the overall exposure and to a limited extent, foreign currency risk can be mitigated by holding assets across a diversified portfolio of currencies. The RBA holds foreign reserves in seven currencies – the US dollar, euro, Japanese yen, Canadian dollar, Chinese renminbi, UK pound sterling and South Korean won.

The RBA also undertakes foreign currency swaps to assist its daily domestic liquidity management and to manage foreign reserve assets. These instruments carry no foreign exchange risk.

Concentration of foreign exchange

The RBA's net holdings of foreign exchange (excluding Special Drawing Rights and Asian Bond Fund 2) were distributed as follows as at 30 June:

	Per cent of foreign exchange	
	2017	**2016**
US dollar	55	55
Euro	20	20
Japanese yen	5	5
Canadian dollar	5	5
Chinese renminbi	5	5
UK pound sterling	5	5
South Korean won	5	5
Total foreign exchange	100	100

Sensitivity to foreign exchange risk

The sensitivity of the RBA's profit and equity to a movement of +/–10 per cent in the value of the Australian dollar exchange rate as at 30 June is shown below. These figures are generally reflective of the RBA's exposure over the financial year.

	2017 $M	2016 $M
Change in profit/equity due to a 10 per cent appreciation in the reserves-weighted value of the A$	(4,715)	(4,845)
Change in profit/equity due to a 10 per cent depreciation in the reserves-weighted value of the A$	5,763	5,922

Interest rate risk

Interest rate risk is the risk that the fair value or cash flows of financial instruments will fluctuate because of movements in market interest rates. The RBA faces interest rate risk because most of its assets are financial assets that have a fixed income stream, such as Australian dollar and foreign currency securities. The price of such securities rises when market interest rates decline, and it falls if market rates rise. Interest rate risk increases with the maturity of a security. Interest rate risk on foreign assets is controlled through limits on the duration of these portfolios. Interest rate risk on Australian dollar assets is relatively low as most of the portfolio is held in short-term reverse repurchase agreements.

Sensitivity to interest rate risk

The figures below show the effect on the RBA's profit and equity of a movement of +/–1 percentage point in interest rates, given the level, composition and modified duration of the RBA's foreign currency and Australian dollar securities as at 30 June.

	2017 $M	2016 $M
Change in profit/equity due to movements of +/–1 percentage point across yield curves:		
Foreign currency securities	–/+287	–/+339
Australian dollar securities	–/+157	–/+144

Liquidity risk

Liquidity risk is the risk that the RBA will not have the resources required at a particular time to meet its obligations to settle its financial liabilities. As the ultimate source of liquidity in Australian dollars, the RBA can create liquidity in unlimited amounts in Australian dollars at any time. A small component of the RBA's liabilities is in foreign currencies, namely foreign repurchase agreements.

Liquidity risk may also be associated with the RBA, in extraordinary circumstances, being forced to sell a financial asset at a price less than its fair value. The RBA manages this risk by holding a diversified portfolio of highly liquid Australian dollar and foreign currency assets.

The analysis of portfolio maturity in the table that follows is based on the RBA's contracted portfolio as reported in the RBA's Statement of Financial Position. All financial instruments are shown at their remaining term to maturity, which is equivalent to the repricing period. Other liabilities include amounts outstanding under repurchase agreements. Foreign currency swaps reflect the gross settlement amount of the RBA's outstanding foreign currency swap positions.

Maturity Analysis – as at 30 June 2017

	Balance sheet total $M	Contracted maturity $M On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity $M	Weighted average effective rate %
Assets								
Cash and cash equivalents	221	41	179	–	–	–	1	1.21
Australian dollar investments								
Securities sold under repurchase agreements	–	–	–	–	–	–	–	na
Securities purchased under repurchase agreements	90,303	–	63,198	800	–	–	26,305	1.65
Other securities	14,068	–	4,579	7,048	1,383	1,058	–	1.77
Accrued interest	398	–	392	6	–	–	–	na
	104,769							
Foreign currency investments								
Balances with central banks	20,340	19,624	716	–	–	–	–	0.04
Securities sold under repurchase agreements	1,580	–	–	842	738	–	–	1.30
Securities purchased under repurchase agreements	4,134	–	4,134	–	–	–	–	1.06
Other securities	57,265	–	34,178	11,440	5,806	122	5,719	0.40
Deposits	194	–	193	–	–	–	1	1.05
Cash collateral provided	–	–	–	–	–	–	–	na
Accrued interest	64	–	45	19	–	–	–	na
	83,577							
Gold								
Gold holdings on loan	365	–	209	156	–	–	–	0.21
Gold holdings	3,782	–	–	–	–	–	3,782	na
	4,147							
Property, plant & equipment	741	–	–	–	–	–	741	na
Other assets	557	–	25	7	5	2	518	na
Total assets	194,012	19,665	107,848	20,318	7,932	1,182	37,067	1.05
Liabilities								
Deposits	92,669	33,682	58,987	–	–	–	–	1.56
Distribution payable to the Commonwealth	1,286	–	1,066	220	–	–	–	na
Cash collateral received	1,108	–	1,108	–	–	–	–	1.50
Australian banknotes on issue	73,623	–	–	–	–	–	73,623	0.05
Other liabilities	3,563	–	3,354	–	–	–	209	0.42
Total liabilities	172,249	33,682	64,515	220	–	–	73,832	0.88
Capital and reserves	21,763							
Total balance sheet	194,012							
Swaps								
Australian dollars								
Contractual outflow	(170)	–	(170)	–	–	–	–	
Contractual inflow	28,815	–	28,815	–	–	–	–	
	28,645	–	28,645	–	–	–	–	
Foreign currency								
Contractual outflow	(52,745)	–	(52,745)	–	–	–	–	
Contractual inflow	24,100	–	24,100	–	–	–	–	
	(28,645)	–	(28,645)	–	–	–	–	

Maturity Analysis – as at 30 June 2016

	Balance sheet total $M	Contracted maturity $M					No specified maturity $M	Weighted average effective rate %
		On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years		
Assets								
Cash and cash equivalents	367	30	336	–	–	–	1	1.50
Australian dollar investments								
Securities sold under repurchase agreements	35	–	–	–	–	35	–	2.51
Securities purchased under repurchase agreements	83,223	–	58,315	1,828	–	–	23,080	1.83
Other securities	5,069	–	–	–	3,922	1,147	–	1.80
Accrued interest	173	–	163	10	–	–	–	na
	88,500							
Foreign currency investments								
Balances with central banks	8,135	7,394	741	–	–	–	–	0.04
Securities sold under repurchase agreements	4,491	–	–	3,463	1,028	–	–	0.40
Securities purchased under repurchase agreements	5,873	–	5,873	–	–	–	–	0.67
Other securities	51,931	–	28,411	11,356	6,139	510	5,515	0.09
Deposits	42	–	42	–	–	–	–	0.44
Cash collateral provided	2,329	–	2,329	–	–	–	–	1.75
Accrued interest	78	–	56	22	–	–	–	na
	72,879							
Gold								
Gold holdings on loan	402	–	230	172	–	–	–	0.22
Gold holdings	4,165	–	–	–	–	–	4,165	na
	4,567							
Property, plant & equipment	640	–	–	–	–	–	640	na
Other assets	536	–	23	4	6	2	501	na
Total assets	167,489	7,424	96,519	16,855	11,095	1,694	33,902	1.03
Liabilities								
Deposits	61,210	30,943	30,267	–	–	–	–	1.69
Distribution payable to the Commonwealth	3,222	–	3,222	–	–	–	–	na
Cash collateral received	–	–	–	–	–	–	–	na
Australian banknotes on issue	70,209	–	–	–	–	–	70,209	0.06
Other liabilities	8,936	–	8,346	–	–	–	590	0.26
Total liabilities	143,577	30,943	41,835	–	–	–	70,799	0.77
Capital and reserves	23,912							
Total balance sheet	167,489							
Swaps								
Australian dollars								
Contractual outflow	(115)	–	(115)	–	–	–	–	
Contractual inflow	9,255	–	9,255	–	–	–	–	
	9,140	–	9,140	–	–	–	–	
Foreign currency								
Contractual outflow	(34,472)	–	(34,472)	–	–	–	–	
Contractual inflow	25,332	–	25,332	–	–	–	–	
	(9,140)	–	(9,140)	–	–	–	–	

Credit risk

Credit risk is the potential for financial loss arising from an issuer or counterparty defaulting on its obligations to: repay principal; make interest payments due on an asset; or settle a transaction. The RBA's credit exposure is managed within a framework designed to contain risk to a level consistent with its very low appetite for such risk. In particular, credit risk is controlled by: holding securities issued by a limited number of highly rated governments, government-guaranteed agencies and supranational organisations; and holding high-quality collateral against reverse repurchase agreements.

The RBA's maximum exposure to credit risk for each class of recognised financial assets, other than derivatives, is the carrying amount of those assets as indicated in the balance sheet.

The RBA's maximum credit risk exposure to derivative financial instruments is:

1. ***Foreign exchange swaps*** – As at 30 June 2017, the RBA was under contract to purchase $24.1 billion of foreign currency ($25.3 billion at 30 June 2016) and sell $52.7 billion of foreign currency ($34.5 billion at 30 June 2016). As of that date there was a net unrealised gain of $1.5 billion on these swap positions included in net profit ($1.9 billion unrealised loss at 30 June 2016).

   The RBA has a credit exposure from foreign exchange swaps because of the risk that a counterparty might fail to deliver the second leg of a swap, a sum that would then have to be replaced in the market, potentially at a loss. To manage credit risk on swaps, the RBA exchanges collateral with counterparties under terms specified in credit support annexes (CSAs), which cover the potential cost of replacing the swap position in the market if a counterparty fails to deliver. The RBA's CSAs specify that only Australian dollar cash is eligible as collateral. Under CSAs, either party to the agreement may be obliged to deliver collateral with interest paid or received on a monthly basis. At 30 June 2017, the RBA held $1.1 billion of collateral ($2.3 billion of collateral was provided at 30 June 2016).

2. ***Interest rate futures*** – As at 30 June 2017, the amount of credit risk on margin accounts associated with interest rate futures contracts held by the RBA was approximately $0.8 million ($0.4 million at 30 June 2016). As at 30 June 2017, there was an unrealised gain of $0.3 million brought to account on those contracts ($0.2 million unrealised loss at 30 June 2016).

The RBA held no past due or impaired assets at 30 June 2017 or 30 June 2016.

Collateral held under reverse repurchase agreements

Cash invested under reverse repurchase agreements in overseas markets is secured against government securities or securities issued by US agencies; the RBA takes and maintains collateral to the value of 102 per cent of the cash invested. Cash invested under Australian dollar reverse repurchase agreements is secured by securities issued by Australian governments, banks and various corporate and asset-backed securities. The RBA holds collateral equivalent to the amount invested plus a margin according to the risk profile of the collateral held. If the current value of collateral falls by more than a predetermined amount, the counterparty is required to provide additional collateral to restore this margin; the thresholds are specified in the legal agreements which govern these transactions. The management of collateral and cash associated with tri-party repurchase agreements is conducted through a third party, in this case the Australian Securities Exchange. The terms and requirements of tri-party repurchase agreements are broadly consistent with bilateral agreements and the RBA manages the risk in a similar way. The RBA does not sell or re-pledge securities held as collateral under reverse repurchase agreements.

Collateral provided under repurchase agreements

At 30 June 2017, the carrying amount of securities sold and contracted for purchase under repurchase agreements was $1,580 million ($4,527 million at 30 June 2016). Terms and conditions of repurchase agreements are consistent with those for reverse repurchase agreements disclosed above.

Concentration of credit risk

As noted, the RBA operates to minimise its credit risk exposure through comprehensive risk management policy guidelines. The following table indicates the concentration of credit risk in the RBA's investment portfolio.

	Risk rating of security/issuer[(a)]	Risk rating of counterparties[(a)]	Per cent of investments	
			2017	2016
Australian dollar investments				
Holdings of Australian Government Securities	Aaa	na	6.1	1.6
Holdings of semi-government securities	Aaa	na	0.5	0.6
	Aa	na	0.8	0.9
Securities purchased under reverse repurchase agreements	Aaa	Aa	27.4	26.4
	Aaa	A	10.1	10.4
	Aaa	Baa	0.2	0.0
	Aaa	Other[(b)]	1.3	1.1
	Aa	Aa	2.8	8.1
	Aa	A	1.7	1.5
	Aa	Baa	0.2	0.1
	Aa	Other[(b)]	0.1	0.1
	A	Aa	1.7	1.4
	A	A	1.0	0.5
	A	Baa	0.0	0.1
	Baa	Aa	0.0	0.1
	Baa	A	0.1	0.0
Foreign investments				
Holdings of securities	Aaa	na	9.3	10.6
	Aa	na	1.6	3.4
	A	na	17.7	15.3
Securities sold under repurchase agreements	Aaa	Aa	0.0	1.1
	Aaa	A	0.8	1.4
Securities purchased under reverse repurchase agreements	Aaa	Aa	0.3	1.4
	Aaa	A	1.4	1.9
	A	A	0.4	0.2
Deposits	na	Aaa	0.5	0.5
	na	Aa	0.6	0.1
	na	A	9.5	4.3
Other	Aaa	A	0.0	0.4
	Aaa	Other[(b)]	0.1	0.1
	A	A	0.0	1.3
	Other[(b)]	Aa	0.5	0.7
	Other[(b)]	A	0.3	0.1
	Other[(b)]	Other[(b)]	0.0	0.6
Other assets			3.0	3.7
			100.0	100.0

(a) Average of the credit ratings of the three major rating agencies, where available
(b) This category includes counterparties that are not rated

Note 16 – Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date. This is the quoted market price if one is available. The RBA's financial assets measured at fair value include its holdings of Australian dollar securities, foreign government securities, interest rate futures, foreign currency swap contracts and its shareholding in the BIS. Non-financial assets carried on the balance sheet at fair value include the RBA's property and gold holdings. Other than derivatives, there are no financial liabilities measured at fair value.

AASB 13 requires financial and non-financial assets and liabilities measured at fair value to be disclosed according to their position in the fair value hierarchy. This hierarchy has three levels: valuation for Level 1 assets is based on quoted prices in active markets for identical assets; for Level 2 assets valuation is based on quoted prices or other observable market data not included in Level 1; Level 3 assets include inputs to valuation other than observable market data.

The table below presents the RBA's assets and liabilities measured and recognised at fair value and their classification within the fair value hierarchy at 30 June 2017.

	Fair Value			Amortised Cost	Total
	Level 1 $M	Level 2 $M	Level 3 $M	$M	$M
As at 30 June 2017					
Financial assets					
At fair value through profit or loss					
Australian dollar securities	14,276	75	–	na	14,351
Foreign government securities	52,552	4,661	–	na	57,213
Foreign currency swaps	111	1,395	–	na	1,506
Available for sale					
Shares in other institutions	–	–	416	na	416
Loans and receivables	na	na	na	115,530	115,530
	66,939	6,131	416	115,530	189,016
Non-financial assets					
Land and buildings	–	–	551	na	551
Gold holdings	4,146	–	–	na	4,146
Other[(a)]	–	–	–	299	299
	4,146	–	551	299	4,996
Total assets	71,085	6,131	967	115,829	194,012
Financial liabilities					
At fair value through profit or loss					
Foreign currency swaps	–	42	–	na	42
Not at fair value through profit or loss	na	na	na	171,946	171,946
	–	42	–	171,946	171,988
Non-financial liabilities	na	na	na	261	261
Total liabilities	–	42	–	172,207	172,249

(a) Includes plant and equipment. As noted in Note 1(e), the RBA has changed its accounting policy for the measurement of plant and equipment from fair value to cost, with effect 30 June 2017

	Fair Value			Amortised Cost	Total
	Level 1 $M	Level 2 $M	Level 3 $M	$M	$M
As at 30 June 2016					
Financial assets					
At fair value through profit or loss					
Australian dollar securities	5,083	67	–	na	5,150
Foreign government securities	48,021	5,438	–	na	53,459
Foreign currency swaps	–	10	–	na	10
Available for sale					
Shares in other institutions	–	–	415	–	415
Loans and receivables	na	na	na	103,160	103,160
	53,104	5,515	415	103,160	162,194
Non-financial assets					
Land and buildings	–	–	453	na	453
Plant and equipment	–	–	187	na	187
Gold holdings	4,566	–	–	na	4,566
Other	–	–	–	89	89
	4,566	–	640	89	5,295
Total assets	57,670	5,515	1,055	103,249	167,489
Financial liabilities					
At fair value through profit or loss					
Foreign currency swaps	200	1,661	–	na	1,861
Not at fair value through profit or loss	na	na	na	141,093	141,093
	200	1,661	–	141,093	142,954
Non-financial liabilities	na	na	na	623	623
Total liabilities	200	1,661	–	141,716	143,577

The RBA's Level 2 financial instruments include Australian dollar-denominated discount securities and some foreign currency swaps priced with reference to an active market yield or rate, but with an adjustment applied to reflect maturity dates. Prices for some Australian dollar and foreign currency denominated securities are derived from markets that are not considered active.

Level 3 assets include the RBA's shareholding in the BIS and its property. The shareholding in the BIS is valued using the net asset value, as published in annual financial statements of the BIS, less a discount of 30 per cent. The discount applied is based on a Hague Arbitral Tribunal decision on compensation paid to former private shareholders, and subsequent transactions involving the re-allocation of BIS shares. Fair values of the RBA's property incorporate factors such as net market income and capitalisation rates, for property valued using an income capitalisation or a discounted cash flow approach, and depreciation rates for property valued using a depreciable replacement cost methodology.

There were no transfers between levels within the fair value hierarchy during the financial year. Movements in the fair value of the RBA's property during the financial year are detailed in Note 8; the decrease in value of the RBA's shareholding in the BIS solely reflects a valuation loss recognised in Other Comprehensive Income.

Note 17 – Subsequent Events

There are no events subsequent to 30 June 2017 to be disclosed.

Auditor-General for Australia

Australian National Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

Opinion

In my opinion, the financial statements of the Reserve Bank of Australia and its Controlled Entity (together the consolidated entity) for the year ended 30 June 2017:

(a) comply with Australian Accounting Standards and the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*; and

(b) present fairly the financial position of the consolidated entity as at 30 June 2017 and its financial performance and cash flows for the year then ended.

The financial statements of the consolidated entity, which I have audited, comprise the following statements as at 30 June 2017 and for the year then ended:

- Statement of Assurance;
- Statement of Financial Position;
- Statement of Comprehensive Income;
- Statement of Distribution;
- Statement of Changes in Capital and Reserves;
- Cash Flow Statement; and
- Notes to and Forming Part of the Financial Statements, including Accounting Policies and other explanatory information.

Basis for Opinion

I conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of the consolidated entity in accordance with the relevant ethical requirements for financial statement audits conducted by me and my delegates. These include the relevant independence requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* to the extent that they are not in conflict with the *Auditor-General Act 1997* (the Code). I have also fulfilled my other responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the financial statements of the current period. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

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Key audit matter	
Accuracy of the liability for the Australian banknotes *Refer to Note 1 (b) Financial instruments: Australian banknotes on issue.* Australian banknotes on issue relates directly to one of the Reserve Bank of Australia's key roles, the issuance of currency, as defined in the *Reserve Bank Act 1959* and is a key audit matter due to: • high interest to the users of the financial statements; • the balance is significant relative to the Reserve Bank of Australia's Statement of Financial Position; and • complexity in assessing the accuracy of the liability for Australian banknotes on issue that are placed in circulation in the economy. The balance of Australian banknotes on issue represents the value of all bank notes on issue in Australia and the liability is measured at the face value of all Australian bank notes issued less any bank notes cancelled.	**How the audit addressed the matter** To audit the Australian banknotes on issue, I performed the following audit procedures: • Tested general IT controls and those controls relevant to the accurate recording of the issuance and return of bank notes within the system responsible for recording the balance of Australian banknotes on issue. • Assessed the movement in Australian banknotes on issue against known comparative trends. Demand for bank notes is driven by underlying economic activity. I therefore compared movements in Australian banknotes on issue against underlying economic activity, in particular household final consumption expenditure (HFCE). HFCE is produced by the Australian Bureau of Statistics and measures household expenditure. • I performed a comparison of current year movements against prior year patterns. I also performed a trend analysis on Australian banknotes on issue against prior periods focussing on the number of notes issued by denomination.

Key audit matter	

Valuation of Australian dollar and foreign currency investments
 	
Refer to Note 1 (b) Financial instruments, Note 15 Financial Instruments and Risk and Note 16 Fair Value.
 	
Valuation of Australian dollar and foreign currency investments was a key audit matter due to the significant size relative to the Reserve Bank of Australia's Statement of Financial Position ($188,346m) and the complexity inherent in valuing a range of investments using different methodologies.
 	
The portfolio of investments primarily comprises Australian dollar securities, foreign currency securities, repurchase agreements, deposits with other central banks, and foreign currency swap contracts. All investments are held at fair value except for repurchase agreements which are held at amortised cost.
	How the audit addressed the matter
	
	To audit the valuation of Australian dollar and foreign currency investments, I performed the following audit procedures:
	
	• Tested general IT controls on the Reserve Bank of Australia's investment trading system.
	• Tested controls relevant to the accurate recording of the purchase and sale of investments.
	• Tested controls relevant to the ongoing monitoring of the collateralisation of repurchase agreements.
	• Tested year-end valuations of Australian dollar and foreign currency securities using the following procedures to address the different valuation methodologies:
	  ◦ Agreed year-end valuations of Australian dollar and foreign currency securities to independent pricing sources.
	  ◦ Tested the year-end valuations for all foreign currency swaps using independent observable pricing inputs.
	  ◦ Tested that repurchase agreements were appropriately collateralised in line with the Reserve Bank of Australia's policy. As part of this, for a sample of securities held as collateral I agreed the valuations to independent pricing sources.
	  ◦ Obtained independent confirmation from other central banks regarding value of deposits held.

Other Information

The Accountable Authority is responsible for the other information. The other information obtained at the date of this auditor's report is the Annual Performance Statement for 2016/17 and the Capital Framework for the year ended 30 June 2017 but does not include the financial statements and my auditor's report thereon.

My opinion on the financial statements does not cover the other information and accordingly I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Accountable Authority's Responsibility for the Financial Statements

As the Accountable Authority of the Reserve Bank of Australia the Governor is responsible under the *Public Governance, Performance and Accountability Act 2013* for the preparation and fair presentation of annual financial statements that comply with Australian Accounting Standards and the rules made under that Act. The Governor is also responsible for such internal control as the Governor determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Governor is responsible for assessing the consolidated entity's ability to continue as a going concern, taking into account whether the entity's operations will cease as a result of an administrative restructure or for any other reason. The Governor is also responsible for disclosing matters related to going concern as applicable and using the going concern basis of accounting unless the assessment indicates that it is not appropriate.

Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian National Audit Office Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the Australian National Audit Office Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the consolidated entity's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Accountable Authority;

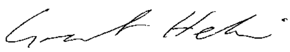
- conclude on the appropriateness of the Accountable Authority's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the consolidated entity's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the consolidated entity to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation; and
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the consolidated entity to express an opinion on the financial report. I am responsible for the direction, supervision and performance of the consolidated entity audit. I remain solely responsible for my audit opinion.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

From the matters communicated with those charged with governance, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters.

I describe these matters in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Australian National Audit Office



Grant Hehir

Auditor-General

Canberra

16 August 2017

Part 5: Indexes

Statutory Reporting Requirements Index

The *Reserve Bank Annual Report 2017* complies with the reporting requirements of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), rules made under the PGPA Act and other applicable legislation.

To assist readers locate this information, the index of annual report statutory reporting requirements identifies where relevant information can be found in this annual report.

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Abbreviations

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AAS	Australian Accounting Standards
ABF	Asian Bond Fund
ABF1	Asian Bond Fund 1
ABF2	Asian Bond Fund 2
ADI	Authorised deposit-taking institution
AGS	Australian Government Securities
AGV	Analytical Group on Vulnerabilities (of the FSB)
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
APRA	Australian Prudential Regulation Authority
ASD	Australian Signals Directorate
ASIC	Australian Securities and Investments Commission
ATFC	Advisory Task Force on the Codes
BCBS	Basel Committee on Banking Supervision (of the BIS)
BIS	Bank for International Settlements
BRS	Business Resumption Site
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CCP	central counterparty
CEDA	Committee for Economic Development of Australia
CFR	Council of Financial Regulators
CGFS	Committee on the Global Financial System (of the BIS)
CHESS	Clearing House Electronic Sub-register System
CLF	Committed Liquidity Facility
CPMI	Committee on Payments and Market Infrastructures (of the BIS)
CPRs	Commonwealth Procurement Rules
CSA	Credit support annex
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
eftpos	electronic funds transfer at point of sale
ERG	Employee Resource Group
ES	Exchange Settlement
ESA	Exchange Settlement Account
fintech	financial technology
FIN	Financial Innovation Network (of the FSB)
FMI	financial market infrastructure
FRR	Financial Reporting Rule
FOI	Freedom of Information
FOI Act	*Freedom of Information Act 1982*
FSAP	Financial Sector Assessment Program (of the IMF)
FSB	Financial Stability Board
FSS	Fast Settlement Service (of RITS)
FTE	full-time equivalent
FX	foreign exchange

FXWG	Foreign Exchange Working Group (of the BIS)
G20	Group of Twenty
G-SIB	global systemically important bank
GHOS	Group of Governors and Heads of Supervision
GPF	Government Partnership Fund (with Indonesia)
HQLA	high-quality liquid assets
IMF	International Monetary Fund
IMSG	Implementation Monitoring Standing Group (a CPMI-IOSCO group)
IOSCO	International Organization of Securities Commissions
IPS	Information Publication Scheme
ISDA	International Swaps and Derivatives Association
IT	information technology
KRW	South Korean Won
LCR	Liquidity Coverage Ratio
MC	Markets Committee (of the BIS)
MEF	multi-employer fund
MFSC	Monetary and Financial Stability Committee (of EMEAP)
MPG	Macroprudential Supervision Group (of the BCBS)
NBS	National Banknote Site
NGB	Next Generation Banknote
NPA	Note Printing Australia Limited
NPP	New Payments Platform
OECD	Organisation for Economic Co-operation and Development
OPA	Official Public Account
OSF	Officers' Superannuation Fund
PEXA	Property Exchange Australia Limited
PFMI	Principles for Financial Market Infrastructures
PGPA Act	*Public Governance, Performance and Accountability Act 2013*
PSG	Policy Standing Group (a CPMI-IOSCO group)
RAP	Reconciliation Action Plan
RBA	Reserve Bank of Australia
RBRF	Reserve Bank Reserve Fund
RCG	Regional Consultative Group (of the FSB)
RDP	Research Discussion Paper
R&D	research and development
repo	repurchase agreement
ReSG	Resolution Steering Group (of the FSB)
RITS	Reserve Bank Information and Transfer System
RMBS	residential mortgage-backed securities
RTGS	real-time gross settlement
SAR	Special Administrative Region
SCAV	Standing Committee on Assessment of Vulnerabilities (of the FSB)
SCSI	Standing Committee on Standards Implementation (of the FSB)
SDR	Special Drawing Right
Semis	Semi-government securities (Australian state and territory government securities)
SRC	Standing Committee on Supervisory and Regulatory Cooperation (of the FSB)
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TWI	trade-weighted index

WHS	work health and safety
WHS Act	*Work Health and Safety Act 2011*
WGPSS	Working Group on Payment and Settlement Systems

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