

TREASURY EXECUTIVE MINUTE

Minute No/ 12/2178

3 August 2012

Deputy Prime Minister and Treasurer

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KEY POINTS

- On 13 July 2012, Governor Stevens wrote to you advising that the RBA's 2011-12 accounting profit is estimated at around \$1.1 billion, which is marginally higher than the \$948 million estimated at Budget.
 - While this figure is yet to be finalised, the Governor has indicated that any further revisions are not expected to have a material impact.
- The Governor has sought your approval, in accordance with section 30 of the *Reserve Bank Act 1959*, to use the estimated accounting profit to replenish the Reserve Bank Reserve Fund.
 - In September 2011 you provided in-principle agreement to use future profits to replenish the Reserve Bank Reserve Fund before any further dividends are paid (Minute 2011/2803). However the *Reserve Bank Act 1959* requires you to each year provide formal approval of this approach prior to the determination of the Bank's dividends.

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: The Governor has noted publicly in the RBA's 2011 Annual Report (p.1) that using future earnings to replenish the Reserve Bank Reserve Fund, before resuming dividend payments, is a prudent course to take. Section 47E

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ADDITIONAL INFORMATION

- The distribution of the RBA's net profits is determined by you each year after consultation with the RBA Board. Typically this decision is made in July or August, so any dividends received in a year reflect profits in the previous financial year.

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- Following large accounting losses 2009-10 and 2010-11, which led to a substantial depletion of the RBA's capital, you provided in-principle agreement in September 2011 to the Reserve Bank board to use future profits to replenish the RBRF to its desired level (Minute 2011/2803).
- The Reserve Bank Reserve Fund (RBRF) is a general reserve to provide capacity to absorb losses arising from falls in the value of the RBA's assets that cannot be absorbed by the RBA's other sources.
 - The RBRF was established by section 29 of the *Reserve Bank Act 1959* (Reserve Bank Act).
 - The other reserves making up the RBA's capital are the unrealised profit reserve, which holds unrealised gains on the RBA's traded assets, and the asset revaluation reserves, which house mark-to-market gains made on specific non-traded assets, primarily its gold holding.
- Since 2001, the RBA board has aimed to keep the RBRF's balance to at least 10 per cent of assets at risk; a level they have deemed appropriate for being able to absorb losses when required. Over the past two years, the balance has fallen well below that target.
 - The RBA suffered large accounting losses in the 2009-10 and 2010-11 financial years, primarily as a result of the valuation losses suffered on its foreign currency holdings.
 - : As at June 30 2011, the RBA held around \$40 billion worth of unhedged net foreign reserves, which are held so as to provide capacity to intervene under conditions of market turmoil.
 - As of 31 January 2012, the RBRF had an estimated balance of \$1.6 billion (Table 1). At these levels, transfers of around \$4.7 billion would be required for the RBRF to be restored to its targeted level of 10 per cent of assets at risk.
- Unlike the case for typical banks, the Reserve Bank Act provides no recourse for the RBA to seek a capital injection from its shareholder (the Government). This means the Bank can only increase its capital by retaining earnings.
- Net profits of the RBA can be paid as a dividend to the Commonwealth once you have determined, after consultation with the Reserve Bank Board, on the amount to be set aside for contingencies and for the RBRF.
 - Distributions to the Commonwealth are covered under section 30 of the Reserve Bank Act. The Reserve Bank Act makes no allowance for balances of the reserves to be transferred as a dividend independent of this.

IN CONFIDENCE

Table 1: RBA capital and reserves, as at:

	30-Jun-09	30-Jun-10	30-Jun-11	31-Jan-12
	\$m	\$m	\$m	\$m
Capital	40	40	40	40
Unrealised Profit Reserve	2,237	0	0	0
Reserve Bank Reserve Fund	6,863	6,183	1,317	1,622
Asset Revaluation Reserve	3,308	4,087	3,921	4,523
Total	12,448	10,310	5,278	6,185

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