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NZ FMOA Chairperson's Report

Welcome to the semi annual FMOA Newsletter.

I hope you find the newsletter informative and interesting and I encourage you to disseminate to your operational staff.

If there is any topic you would like covered in future newsletters, or you have any feedback on this newsletter please email maria@fmoa.org.nz.

World Markets

Markets have dropped since mid-May, with Tokyo's Nikkei 225 equity index down 14.2%, FTSE Eurofirst 300 9.2%, and Wall Street's S&P 500 fell 5.4%. The NZX 50 index between 15 May and 12 June declined 20.05 points from 3633.08 to 3613.03. Commodity prices have been similarly volatile. However, the Bank of International Settlements (BIS) identified short-term interest rate futures had been more or less unchanged since April. Gold, a traditional safe haven in times of rising inflation, has fallen 11.6 per cent since mid-May. Finance ministers of the Group of Eight industrialised countries on the 11th June said "global economic growth remained strong but with oil still trading at about \$70 a barrel, they warned of the threat to growth from high energy prices and trade imbalances".

Research by the BIS senior economist Christian Upper said "We don't find much evidence for a change in the intrinsic value of assets. Fundamentals did not change in any significant way in mid-May. The drop in the price of higher-risk assets seemed to represent a weakening of investors' appetite for risk. This resulted in a re-allocation of portfolios in favour of highly rated instruments such as government bonds."

Market commentators are concerned high oil prices may be starting to feed through into broader inflationary pressures. This could force central banks to increase interest rates, draining liquidity from global markets, and last week we saw a number of countries do exactly this.

The International Monetary Fund has nominated China and Saudi Arabia to participate in the IMF's efforts to resolve trade imbalances. They will engage in its first "multilateral consultations" aimed at "how to address global imbalances while maintaining robust global growth". The other three participants will be economics superpowers of the US, Eurozone and Japan.

Europe

The harmonisation of practices across the EU Securities markets appears to have lost some impetus despite the plethora of consultations emanating from the regulators and Euroclear. This may indicate some slippage from target dates in 2007. It is only now that market participants start to understand the full implications of the enactment of the Markets in Financial Instruments Directive (MiFID) as they weigh up the cost-benefit analysis.

United Kingdom

Dematerialisation

The current Consultation on Dematerialisation is being led by the Institute of Chartered Secretaries and Administrators (ICSA) and comments should be made to ICSA by 30 June 2006. The Consultation is wide ranging and has the support of the DTI and H M Treasury. The proposed solution to remove paper from Clearing and Settlement from the UK retail market has been warmly received by the vast majority of the market.

Shareholder Enfranchisement Debate

Legislation designed to improve shareholder rights and the rights of underlying beneficial owners is being enacted in the UK and across the EU. There is a suggestion that UK Companies should be obliged to enfranchise investors holding their shares via a Nominee and this is being debated during the Company Law Reform Bill's current passage through Parliament.

United States

Dematerialisation & Proxy Reform

The push towards dematerialisation and broader deregulation of the proxy voting process continues in North America. In May 2005, the US state of Delaware passed legislation to remove the requirement that corporations offer paper stock certificates to holders. Almost 50% of all US publicly-traded companies (including 58% of the Fortune 500) incorporate in Delaware, which means this change is a significant step toward full dematerialisation of the US environment. Also, the success of National Instrument 54-101 in Canada has demonstrated the value of proxy reform to regulatory bodies in the US.

Closer to home

Generally participants in financial services are facing issues of globalisation, demographics, regulation, risk and technology as they meet the challenge of customer-centric strategies to enable them to meet the demands and needs of their clients through the value chain.

In recent times we have seen healthy competition in the Exchange landscape in particular US and European bids for LSE. In our own backyard we have seen the merger of ASX and SFE. A number of questions come to mind for New Zealand:

- Are we a utility or an organic service organization?
- Will we compete in Australia or will they compete in NZ?
- Will there be infrastructural rationalization within the NZ market?
- Will customers be able to trade multiple products via multiple channels and settle through a single infrastructure? At face value it would appear illogical to have multiple infrastructures given the scale of the NZ market.

In New Zealand the industry is undergoing a landslide of regulatory change. FMOA has always been an information conduit for 'change' so as members' obtain understanding of the impact to operations. As we consider new regulatory regimes, signalled by government to be on a co-regulatory basis, we can expect various interested parties to collaborate for desired outcomes in a proactive manner. If we consider this, together with the outcomes of the membership survey and the desire to receive information on market practice, best practice and we clearly need infrastructure that provides the necessary resources. Initial discussions have been held with INFINZ discussing various scenarios to see if the organizations are aligned to deliver mutual benefit from any potential amalgamation. As the committee investigates options we will keep members informed. In the meantime we welcome any feedback in this area.

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Accreditation or competency based education – this was the question put to members at the conference. There was definite support to provide education and information for operations staff. Proficio provided an extremely competitive pricing model for a competency based scheme which will give NZ industry coverage, can be integrated with INFINZ/AFMA, on-line courses can be implemented quickly on a hosted environment, then progressively build tutorials specific to our requirements. The committee will schedule a half day event in Wellington in early August. We will advise the date in the near future.

This will enable members to view the product offering. The intention is this would lead into detailed working group sessions to enable creation of NZ requirements for identified gaps. At the conference we requested organizations to volunteer resources to assist in this area, we have received some nominations, thank you. There is a view by some that in time this will lead to formal accreditation. However it is very difficult to move a market from 'minimal educational material' to full blown accreditation where ones employment is dependent on attaining the prescribed standards. So the thought process has been measured incremental steps.

We also have a mandated savings regime in New Zealand 01 April 07, albeit participation is not compulsory, is this the stepping stone to compulsion and capital gains tax.

Organisations are grappling with proposed tax changes, advisor, product and provider regulation, together with finalisation of Kiwisaver details necessary to enable implementation. This will lead to transformative changes at both the horizontal and vertical levels, as manufacturing becomes more flexible and creative and distribution more nimble and aligned to client needs.

Yet, New Zealand's reputation is tarred with our inability to consistently supply power to the business community, with last week's power failure in Auckland – unbelievable that almost 8 years after the 1998 power crisis, Auckland CBD is dependent on a single sub-station.

You will notice our later publication of the newsletter, timed to be distributed post the conference. The committee also agreed to include an additional page with photos of conference participants. The committee would like to thank Maria Chandler for her work with respect to conference organisation, chief photographer and publication of this newsletter.

Barbara Baker
FMOA Chairperson

Basel II

How much capital is necessary to serve as a sufficient buffer to ensure soundness and stability of the international banking system including unexpected losses or stress events?

Basel II is a new framework for standards governing capital adequacy of internationally active banks. Significant advances have been made with respect to the recognition of varying levels of sophistication and a greater emphasis on risk sensitivity. Included is the foresight to provide the necessary flexibility to enable future evolution with advances in capital market practices.

Basel II is the result of work by the Basel Committee on Banking Supervision, which draws on the regulatory expertise of G10 countries, but incorporates input from many other countries. There are three core pillars within the framework; minimum capital requirements, supervisory review and market disciplines.

The Three Pillars:

Pillar 1 Minimum Capital Requirements

Pillar one calculates minimum capital requirements against four major bank risks – credit risk, operational risk, market risk, and securitisation risk. For each risk banks have the option of utilising either a standardised approach set by the framework or their own internal models, as accredited by regulators, to determined minimum capital requirements.

Pillar 2 Supervisory Review

Pillar two recognizes the necessity for supervisors to review banks' internal assessments of their overall risks and capital needs. Supervisors will evaluate the activities and risk profiles of banks, over and above the risks defined in pillar one, to determine whether the banks should hold higher levels of capital than what is specified under Pillar 1.

Pillar 3 Market Disciplines

Pillar three enhances the degree of transparency in bank's public reporting. There is an expectation that this will provide a basis for more informed analysis by markets and customers on banks' financial condition and risk management. Such information will encourage market discipline which, in turn, will support the efforts of bank supervisors to encourage prudent management by banks.

Reserve Bank

The RBNZ's implementation of Basel II is focused on making bank capital requirements more sensitive to risk, and particularly risks specific to the New Zealand environment. "These include the exposure of the economy to international commodity markets, and the high concentration of housing loans in New Zealand bank portfolios," Mr Orr said. Basel II is

not intend to lead to large changes in the level of capital in the banking system overall.

Banks wishing to implement the Basel II internal models approaches - Internal Ratings Based (IRB) approaches to credit risk and Advanced Measurement Approach (AMA) to operational risk - in January 2008 must apply to the Reserve Bank for accreditation to use these approaches by 3 July 2006.

The Reserve Bank will require a one-year parallel-run period starting from January 2007 for locally-incorporated banks applying for accreditation to use the internal model approaches in July 2006. During this period, banks will be required to produce Basel II capital calculations while continuing to meet their existing Basel I capital requirements. There will be rigid application, particularly in the first years of implementation to ensure capital levels do not decline significantly.

The RBNZ and New Zealand Banks are collectively working towards an implementation date of "Jan 2008".

PROPOSED CHANGES TO LIQUIDITY MANAGEMENT FOR THE BANKING SYSTEM

In the Y04/05 Annual report from the RBNZ a highlighted priority was to ensure adequate liquidity was provided to the banking system, with collateral requirements and risks being balanced appropriately between RBNZ and the banking sector.

RBNZ currently uses the following methods to supply liquidity

- Open Market Operations (OMO)
- Foreign Exchange (FX) Swaps
- Overnight reverse repurchase facility (ORRF)
- Autorepo facility (autorepo)

Symptoms of Stress on Liquidity

- Delayed and 'just-in-time' payments between market participants
- Failed payments
- An increased and unsatisfactory level of underbid OMO's
- Rise in both ORRF and Autorepo

The proposal sets out the clear objective that incentives should be put in place to foster an environment where the commercial banks get liquidity from each other and deal with the RBNZ only when liquidity is not otherwise available from the market.

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FMOA/Austraclear conference in Auckland
From left Barbara Baker (FMOA Chairperson), Jayshree Das from UBS and Kathy Gruschow from McDouall Stuart



FMOA/Austraclear conference in Auckland
From left, Mark Lawrence of ANZ National, Adrienne Barlow of RBNZ, Julie Allen from Deutsche Bank and Donna McDiarmid from RBNZ

Two key issues of relevance for review

- The level of cash routinely left in the payment system each day; and
- The availability of acceptable securities that banks can use to obtain liquidity from the bank intraday or overnight.

Three options

- Making minor adjustments to system as it stands
- Implementing an 'on-demand' liquidity facility
- Integrating intraday and overnight cash markets and significantly increase the amount of settlement cast routinely left in the system

Preferred Regime

The proposal is to move to a fully cashed up payment system. In such a system the settlement cash level would be set by the RBNZ from time to time, and expect changes in volume would be relatively infrequent to provide ESAS participants with certainty over supply of liquidity. Bank work indicates a level around 7 billion is appropriate. It is suggested where at this level the day-to-day balancing of Crown flows would be managed perhaps within +/-500m corridor around the target level.

Benefits Preferred Regime

- Proposed scheme is scalable and flexible
- Settlement accounts balances become natural part of balance sheets
- Increased base level of settlement account balances and foster development of inter-bank cash market
- To support above RBNZ would probably operate more liquid money market instruments than in the past.

Next steps

The RBNZ is considering the submissions it has received from interested parties on its Liquidity Management Review. The RBNZ expects to issue a paper in late June setting out the changes it intends to make.

KEY OPERATIONAL ISSUES NEXT 12 MONTHS

Below lists the items identified by FMOA Members

- Operational Risk
- Staff training
- Competency Accreditation
- Straight Through Processing
- Understanding market practice, and best practice
- Restructuring and management of the process
- Outsourcing offshore
- Impact of 'Kiwisaver'
- Financial Reporting Standards
- Improve 'manual' market processes

Membership Survey Outcomes

With a new incoming committee this presented an opportunity to take a closer look at our purpose and how we were achieving that purpose.

The Financial Markets Operations Association is a group of professional people from the operations area of the financial market sector. We provide services and support to our members to help you with:

- continuing education of administration staff
- setting of market standards and practices
- resolution of market issues
- networking with other market participants

A membership survey was conducted to elicit comment and views from member's on how we were meeting your needs. The outcome from a networking perspective we established these needs were primarily being met and positive feedback was received. Where we failed to meet our objectives was in two key area's education and market standards and practices. The feedback sets a clear path on the future direction for FMOA.

Continuing education of administration staff

- Very useful as industry has become very insular
- NZ market definitely lacks educational material
- Focus on industry wide 'operations' – a definite gap
- Would like to see closer relationship with INFINZ broadens what information FMOA can access.
- Would like to see FMOA leveraging of AFOA infrastructure without becoming another AFOA

- The need for greater consultation and information regarding pending changes
- Key is to ensure relevance to NZ operations
- We are based offshore, and staff trained offshore through AFMA
- Education already provided through SIA, already have access to INFINZ
- Significant support to re-run operational risk course/seminars.
- Concept targeted breakfast seminars focused on operations good idea

Setting market standards

- It would be useful to have centralized information available
- Rarely is there discussion
- Practices developed overtime (informal)
- No recognition of what is accepted practice or best practice
- Concept of producing industry standards is excellent
 - agreements and processing
 - definitely something that is needed
 - would provide significant industry benefit.
- We never say no to information that would be useful
- Whatever is done needs to consider wider industry participants.
- Industry should work together to achieve (leverage where possible)
- SCOR from Australia customised for NZ sounds good
 - like to understand more
 - concerns over cost

ELECTRONIC FRAUD

Maarten Klienjes, Head of New Zealand Police, Electronic Fraud Unit presentation at the conference contained valuable information for all attendees and provoked significant thought regarding a serious issue facing our operational environments today. We have created a link to his presentation on our website for those who were unable to attend the conference. <http://www.fmoa.org.nz\FMOA Auckland 260506 - E-crime doc.ppt>

INFINZ

Paul Hocking from INFINZ attended our conference and presented to members, an in depth look at what INFINZ is all about, goals and what INFINZ could offer FMOA members.

Potential Benefits:

- On-going journal with topics of interest
- More frequent meetings and meetings tailored to market operations
- Improved representation through permanent and focused secretariat
- Focus on advocacy and lobbying
- Networking advantages with other operatives/professional in the industry
- Cost effective conferences, with international speakers.
- Solves our infrastructure issue
- Retention of identity

If any members wish to discuss this concept please do not hesitate to contact Lesley Galloway: lesley.galloway@etos.co.nz <http://www.fmoa.org.nz/INFINZ Presentation May 2006.pdf>



FMOA/Austraclear conference in Auckland
Mike Morgan and Settlements Staff from NZ Guardian Trust

SECURITIES LENDING

Share-lending rules (Clauses 2(13), 103, 123 and 142)

The IRD website advises three remedial amendments will be made to the recently enacted share-lending rules. The amendments will clarify that where resident withholding tax (RWT) has been paid by the share user as part of a share-

lending arrangement, that the share supplier does not get an imputation credit for that RWT as well as an imputation credit under section NF 8B.

The amendments will also remove unnecessary requirements that are not relevant to share-lending arrangements from the share-lending statement and dividend withholding payment credit refund sections. These amendments accord with previously announced policy objectives of this reform.

UP-COMING KEY DATES

June 2006	RBNZ issues paper setting out the changes it intends to make post it's Liquidity Management Review
June 2006	MED is scheduled to release a discussion document mid-year outlining its proposed structure and design details for the APB regulatory regime.
July 2006	Expected implementation Taxation changes (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Bill this legislation impacts Securities Lending effective from 1 July
July 2006	FMOA Committee meeting
August 2006	FMOA Education Sub Committee meeting with Andrew Bell of Proficio
Nov 2006	FMOA/Austraclear Conference, Wellington
Jan 2007	RBNZ Basel II parallel testing run commences
01 Apr 2007	Implementation Kiwisaver
01 Apr 2007	Implementation Taxation Changes Investments
01 Apr 2007	Implementation regulatory regime advisors, products, providers
Jan 2008	RBNZ Basel II Implementation

FMOA SOCIETY PAGE

On Friday 26th May FMOA and Austraclear held their conference in Auckland. It was a day of informative speakers including Maarten Kleinjies from E-Crime, and a forum for ongoing education modules for the financial market's operational staff. Discussions carried on over drinks and nibbles with a who's who of FMOA members.



FMOA/Austraclear conference in Auckland
Ryan Cuthbertson of Citigroup (left) and Paul Chandler of ANZ National (right).

INFLUENZA PANDEMIC PLANNING

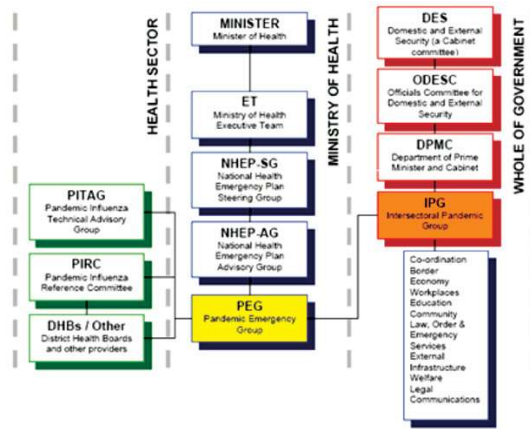
- ARE YOU PREPARED ?

The World Health Organisation (WHO) has warned that the current risk from bird flu becoming the next human influenza pandemic is high. The Ministry of Health (MoH) is currently updating its Pandemic Influenza Action Plan and is leading government-wide work to prepare for a possible pandemic in New Zealand.

For you and your family do you have: a) a plan b) emergency supply kit c) good hygiene standards

New Zealand has been planning for an influenza pandemic for some time. MoH is working with the health sector and a wide range of other government agencies to ensure New Zealand is as prepared as possible for a potential pandemic.

As shown in the following diagram, MoH has set up a government-wide Intersectoral Pandemic Group (IPG). A number of workstreams have been formed under the IPG to plan for and minimise the impact of associated risks.



Continuity planning should include your business's obligations under the Health and Safety in Employment Act 1992. The most relevant sections of the Health and Safety in Employment Act 1992 are:

Section 6: "All practicable steps"

"Every employer shall take all practicable steps to ensure the safety of employees while at work; and in particular shall take all practicable steps to:

- provide and maintain for employees a safe working environment;
- provide and maintain for employees while they are at work facilities

It is not possible to predict how long a pandemic may last. There could be more than one wave of infection during a pandemic period. Each wave could typically last about eight weeks, building to a peak in week four before abating again.

MoH advises that businesses should plan for up to 50% staff absences for periods of about two weeks at the height of a pandemic wave and lower levels of staff absence for a few weeks either side of the peak.

Table 3 Suggested Summary Actions for Businesses during each Alert Code

STAGE	NZ STRATEGY	MoH / DHB ALERT CODE	SUGGESTED ACTIONS FOR BUSINESSES
1	Plan for it (Planning)	WHITE (information / advisory)	<ul style="list-style-type: none"> Review business continuity plans. Identify essential services (including contractors), facilities/plants, other production inputs Plan for up to 50% staff absences for periods of 2-3 weeks at the height of the pandemic, and lower levels of staff absences for a few weeks on either side of the pandemic. Assess core staff and skill requirement needs, and ensure essential positions are backed-up by an alternative staff member Identify ways to increase "social distancing" in the workplace, reduce movement etc. Consider organisational policies to encourage the sick to stay at home, and enable staff to work from home Identify ways to minimise illness amongst staff and customers, and consider how essential messages (e.g. basic hygiene) can be communicated to staff Identify needs for PPE¹² and cleaning equipment, and check air conditioning. Purchase additional contingency supplies.
		YELLOW (Standby)	
2	Keep it out (Border Management)	RED ¹ (Alert)	<ul style="list-style-type: none"> Alert staff to change in pandemic status Activate staff overseas travel restrictions Review/test essential business continuity measures
3	Stamp it out (Cluster Control)	RED ¹ (Alert)	<ul style="list-style-type: none"> Alert staff to change in pandemic status Activate essential business continuity measures Activate measures to minimise introduction and/or spread of influenza in work place (post notices; social distancing, managing ill staff members, workplace cleaning, etc.)
4	Manage it (Pandemic Management)	RED ¹ (Alert)	<ul style="list-style-type: none"> Communicate with staff to promote confidence in the workplace Activate contact tracing where staff become ill at work during Cluster Control phase Activate process for recovered / well staff members to return to work
5	Recover from it (Recovery)	GREEN (Stand down)	<ul style="list-style-type: none"> Manage return to business as normal

For more information: www.med.govt.nz/upload/27552/planning-guide.pdf

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