Overview and conclusions

1. Central banks exist for different purposes than commercial banks. They pursue national welfare, not profits. Their financial results are often a poor guide to their success.
2. Central bank gains and losses belong to society. Beyond this, financial results may be important for a central bank even though it can always create money to pay its bills, cannot be declared bankrupt by a court, and does not exist to make profits. Losses or negative capital may raise doubts – however erroneous – about the central bank's ability to deliver on policy targets, and expose it to political pressure.
3. Standalone financial strength can therefore buttress a central bank's credibility, especially where that has been weakened by its historical record, institutional arrangements or the political climate. Conversely, where credibility is otherwise unquestioned, financial strength may add little to a central bank's capacity to execute policy successfully. This alone makes it challenging to say what level of financial backing a given central bank needs.
4. In addition, financial strength should be scaled to the financial demands of the functions for which the central bank has independent responsibility. These financial demands may be much greater in a crisis than in normal times. Recent experience underscores this point. It is no easy task to assess the financial demands that might be encountered in times of stress for central bank operations, and to understand the specific crisis responsibilities of central banks.
5. If financial resources are scaled to match possible emergency demands, large buffers may build up in normal times, particularly for central banks with wide-ranging crisis management responsibilities. To ensure that central banks have independence in deploying them, such buffers need to be on the balance sheet, and available for use. Achieving this with capital invested in government securities need not be costly when viewed from the perspective of the whole public sector. But legal or practical (eg market pricing) limitations related to the size of the gross public debt, and to the central bank's ability to hold such debt, may exist. Moreover, political risks may arise, given what might (wrongly) appear to be an unneeded pot of public money available to fund desirable projects.
6. The size of financial buffers needed to assure a continuing independent operational and policy capability is affected by accounting policies, profit distribution and recapitalisation mechanisms, capital targets and risk-sharing arrangements. Decisions on these factors should be made in concert with decisions on a central bank's independent responsibilities and its consequent need for independent financial strength:
   - With respect to accounting policies, this may imply departing selectively but transparently from International Financial Reporting Standards.
   - With respect to distribution mechanisms for profits, this requires avoiding a bias towards decapitalisation or arrangements that impede a rapid rebuilding of equity.
   - With respect to risk-sharing arrangements, again the issue is to match financial independence with the demands of policy independence.

Exactly how these decisions are integrated is less important than they be considered as a package – a package designed to support operational and policy effectiveness even during crisis times, while maintaining throughout the trust of the community.

7. The need for financial resources is also a function of the risk that a central bank's finances may be mistakenly thought important for its capacity to function, as if it were a commercial bank. The scale of financial resources required can be reduced by improving the understanding of stakeholders and observers. High-quality financial disclosure, lucid explanations of links to policy and operations, and education of financial sector observers, the public and their political representatives are all important.