3.28 NEW ZEALAND

By Deemple Budhia and Dave Sutich, Australian Securitisation Forum (New Zealand representatives)

SUMMARY

The first covered bond was issued out of New Zealand in June 2010. At that time, New Zealand did not have a legislative covered bond framework and domestic issuers used the well-tested general law-based covered bond approach taken in the UK, France, and Canada. In December 2013, the Reserve Bank of New Zealand (Covered Bonds) Amendment Act 2013 (Amendment Act) amended the Banking (Prudential Supervision) Act 1989 (Act). As a result of the Amendment Act, registered banks are now only permitted to issue covered bonds under programmes registered with the Reserve Bank of New Zealand (RBNZ). The five large New Zealand banks all now operate covered bond programmes.

I. FRAMEWORK

No covered bond regulation was in place in June 2010 when New Zealand covered bonds were first issued and issuance of covered bonds was neither prohibited nor limited by any prudential requirements or other regulation.

Following public consultation, the Amendment Act was passed in December 2013. After the Amendment Act came into force in December 2013, existing covered bond issuers had nine months to register their covered bond programme with the RBNZ in order to be able to continue issuing covered bonds under their programmes. All New Zealand registered banks with covered bond programmes have registered their programmes with the RBNZ, which means that all outstanding New Zealand covered bonds receive the benefit of legislative certainty provided by the Act in relation to liquidation and statutory management.

II. STRUCTURE OF THE ISSUER

As of April 2023, issuers from five New Zealand banking groups have issued covered bonds, being ANZ Bank New Zealand Limited (ANZ), ASB Bank Limited (ASB), Bank of New Zealand (BNZ), Westpac New Zealand Limited (Westpac) and Kiwibank Limited (Kiwibank) (Existing Issuers). With the exception of Kiwibank, all issuers are ultimately owned by Australian parent banks. However, the Australian parent companies do not guarantee the covered bonds. Historically, NZD or AUD denominated bonds have been issued directly by the New Zealand banks, while non-NZD bonds have mostly been issued through the London branches of their respective subsidiaries and are guaranteed by the New Zealand bank. The exception to this is Kiwibank who issues via a New Zealand based company.

The covered bonds are backed by a dynamic cover pool of assets, and the covered bonds rank pari passu to each other. The covered bonds are irrevocably guaranteed by the covered bond guarantor (CB Guarantor) under the covered bond guarantee. The CB Guarantor will only make payments under the bonds when (a) an issuer event of default has occurred, and a notice to pay is served on the CB Guarantor, or (b) a CB Guarantor event of default has occurred and a covered bond guarantee acceleration notice is served on the CB Guarantor and the issuer.

III. COVER ASSETS

The RBNZ, as the prudential supervisor of banks in New Zealand, does not prescribe the type of assets that can be included in the cover pool. The RBNZ consider it sufficient that banks specify asset eligibility criteria in their programme documentation.

The covered bond programmes of the Existing Issuers (Existing Programmes) are backed by a dynamic cover pool of residential housing loans originated in New Zealand. The common eligibility criteria for these housing loans across the programmes are listed below:

> Denominated and repayable only in New Zealand Dollars (NZD);
> Secured by first ranking residential mortgages in New Zealand;
> Housing loans with a term not exceeding 30 years;
> Outstanding principal balance of no more than NZD 1.5mn (Westpac)/NZD 2.0mn (ANZ, ASB, Kiwibank)/ NZD 2.5mn (BNZ); and
> Not in default/have not been in arrears for more than 30 days (ANZ, ASB, Kiwibank, Westpac)/3 months (BNZ).

Some of the issuers have additional features beyond these requirements. Moreover, issuers are also allowed to hold liquid substitution assets. These assets are subject to an overall limit of 10%-15% of the cover pool depending on the issuer (Westpac and BNZ 15%, ANZ, ASB and Kiwibank 10%), with the exception of cash that has no limit.

IV. VALUATION AND LTV CRITERIA

In New Zealand, every property is typically valued during the underwriting process. All five existing covered bond programmes do not restrict the LTV limit for housing loans in the cover pool. However, the Act requires registered covered bond programmes to test whether the value of the cover pool assets is at least equal to the principal amount of outstanding covered bonds. In the case of ASB and Westpac, the Asset Coverage Test (ACT) caps the valuation of the property at 75%. In case of ANZ, BNZ and Kiwibank this cap is set at 80%. In effect, this means the maximum amount of a loan that can count in the ACT test is 75% or 80% of the property value respectively.

V. ASSET-LIABILITY MANAGEMENT

Issuance limit: Through the conditions of registration of each of the Existing Issuers, the RBNZ limits the value of assets that may be encumbered for the benefit of covered bond holders to 10% of the total assets of the issuing bank.

Currency and interest hedging: The housing loans in the cover pool are denominated in NZD. However, covered bonds can be issued in other currencies. This introduces currency risk as the interest payable on the covered bonds will not exactly match the interest received on the housing loans in the cover pool. The interest rate and currency risk is hedged under the existing covered bond programmes.

Soft vs hard bullet structures: The Existing Issuers can issue hard bullet covered bonds or covered bonds with extendable maturity of one year (“soft bullet” bonds). Hard bullet covered bonds will be subject to a 12-month pre-maturity test giving the CB Guarantor 12 months to raise liquidity by selling assets of the pool.

Overcollateralisation (OC): The issuers have committed to various OC levels with the credit rating agencies. In summary, each covered bond programme provides for overcollateralisation to be the greater of the contractually specified amount and such other amount required by the relevant rating agency to maintain the current ratings of the covered bonds. The Act requires Existing Issuers to test at least every 12 months whether the value of the cover pool assets is at least equal to the principal amount of outstanding covered bonds and to notify the RBNZ if this test is not satisfied. In practice this ACT is performed more regularly, at quarterly or monthly intervals, or upon any new covered bond issuance.

VI. COVER POOL MONITOR AND BANKING SUPERVISON

The Act requires registered covered bond issuers to maintain an asset register and to appoint a cover pool monitor. The cover pool monitor must either be a licensed auditor, an auditing firm (where the functions of the cover pool monitor are performed or supervised by a licensed auditor), or a person/firm that has been approved by the RBNZ. In this context, independent means independent from both the issuer and any associated person of the issuer. A person's appointment as auditor does not affect his, her, or its independence. The cover pool monitor must assess and report annually to the issuer regarding the accuracy of the ACT and maintenance of the asset register for the covered bonds.

The Existing Issuers provide investor reports on a monthly or quarterly basis. In addition, monthly or quarterly information is prepared for the credit rating agencies. The credit rating agencies re-calculate the required asset percentage used in the ACT on a regular basis and prior to each issuance under the respective covered bond programme.

If the credit rating of the calculation manager (usually, the issuer) is downgraded below a certain trigger level, the asset monitor will check the arithmetic accuracy of the calculations performed by the calculation manager on a monthly basis. Moreover, (1) if the asset monitor identifies any errors in the calculations performed by the calculation manager which result in a failure of the ACT, or (2) if the adjusted aggregate housing loan amount or the amortisation test aggregate housing loan amount is misstated by the calculation manager by an amount exceeding 1%, or (3) if the asset register has not been maintained as required, then the asset monitor will be required to carry out the applicable check on a monthly basis until the asset monitor is satisfied that no further inaccuracies exist.

VII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

The covered bonds are direct, unsecured, unsubordinated and unconditional obligations of the relevant issuer. In addition, the CB Guarantor guarantees the payments of interest and principal of the covered bonds. The issuer provides a subordinated loan to the CB Guarantor which allows the CB Guarantor to acquire a housing loan portfolio. The portfolio includes housing loans and the related security sold by the seller in accordance with the terms of the mortgage sale agreement.

Holders of registered covered bonds benefit from greater certainty that the security over cover pool assets remains enforceable if the issuing bank were to experience insolvency or be placed into statutory management. The RBNZ must keep a public register of registered covered bond programmes and issuances under each programme. Moreover, the Act requires that the cover pool assets are held by a Special Purpose Vehicle, which is a separate legal entity from the issuer.

Under the Existing Programmes, the sale of the loans and their underlying security by the seller to the CB Guarantor is in the form of assignment of the seller's rights, title, interest and benefit in and to the loans, their related security and the other assets which are being sold. The assignment requires neither a notice to the borrowers nor a registration in the land registry. The "perfection of title" to the CB Guarantor will be triggered by certain trigger events including the notice to pay on the CB Guarantor, downgrade of the issuer to sub-investment grade or insolvency of the issuer. These trigger events will result in the underlying borrowers being notified of the assignment and registration of transfer of the mortgage security with the land registry.

VIII. RISK-WEIGHTING AND COMPLIANCE WITH EUROPEAN LEGISLATION

The RBNZ accepts NZD denominated AAA rated covered bonds for its Domestic Markets Operations. For maturities of less than three years the haircut is 5%. Covered bonds with a maturity of three years or longer are subject to a higher haircut of 8%. This includes covered bonds issued by New Zealand banks.

The covered bonds issued directly by financial institutions with registered offices in New Zealand are neither CRR nor UCITS compliant as both frameworks require the issuer to be based in the EU. These covered bonds, therefore, do not benefit from the lower risk weighting for bank treasuries in the EU.

Issuers: ANZ Bank New Zealand Limited, ASB Bank Limited, Bank of New Zealand, Kiwibank Limited, Westpac New Zealand Limited.

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com or via the following QR code: