Infratil

1 September 2017

Ian Woolford
Prudential Supervision Department Reserve Bank of New Zealand
PO Box 2498
Wellington 6140

CC: Mark Peterson, Rob Everett, James Hartley, Mike Flavill, Jason Green, Danny Keene, Shaun Roberts

Dear Sirs

This is the submission of Infratil Limited in respect of the consultation you are currently undertaking on bank capital.

Our submission is entirely related to a niche feature of the New Zealand banking system which we feel the RBNZ bank capital review has neglected, but which is important to many New Zealand corporate borrowers and the overall effectiveness of the financial system.

RBNZ has an extremely broad remit to oversee and regulate the financial system. The "financial system" is precisely that, a system, involving a vast number of interrelationships. In part these relationships are defined by contracts, but more commonly by trust.

Within the financial system most larger companies undertake more of their debt funding via securities issuance (bonds or notes) than from bank borrowing.

As a percentage of domestic credit, bonds/notes will be only a fraction of what occurs in the USA and larger markets. Reflecting NZ's relatively small number of larger companies and the lack of a securitisation market of any scale. But even though not a large part of the credit pie, it is important. To both borrowers and lenders.

The debt capital markets (DCM) function in a highly-connected way. A company such as Infratil will identify an amount and term of debt it wishes to raise. After liaison with its banks and brokers it will set the terms on the bonds and will arrange their sale. There are a wide array of alternative ways to execute the sales.

Throughout this process, a factor which is at the forefront of the considerations of issuer, intermediaries and investors; is the track record of the issuer's existing bonds. If they have a long history of trading at, say, 0.5% over the comparable government bonds, then there is a high likelihood that this will be roughly the spread of the new bonds. If however their spread-to-governments has bounced around this will be reflected in the cost of the new debt.

The secondary market and the track record has a strong gravitational pull on the new issue market.

The secondary market for bonds is not deep. It largely involves ANZ, BNZ, and Westpac with help on occasions from one or two brokers.

But, even though it's not a deep market, it is quite efficient as regards buy-sell spreads and generally trades securities at prices which are reasonably efficient.

But, as with any securities market, behaviour in periods of stress can be problematic and prices anything but efficient.

The challenge for an issuer, such a Infratil, is how to insure against aberrant market behaviour in periods of stress; because of the impact on the pricing of subsequent issues.

We can establish a buyback capability. That is about it.

But, perversely, having a buyback capability could even be counter-productive if panicking owners of a portfolio of bonds "hit the bid" and sell what they can. Being a buyer until swamped and then stopping, could well be worse than not being a buyer at all. Creating an expectation and not fulfilling it.

Clearly the only plausible remedy for the market in a period of stress is a reasonable number of reliable market makers with good capacity and a vested interest in the market maintaining efficiency.

But this solution is being directly impinged by the RBNZ's capital rules around bank holdings of bonds.

RBNZ is requiring punitive holdings of bank capital. Worse, as we understand it, the capital allocations are ratchetted up if the bonds are not rated, are longer term, or are held for any length of time by a bank.

All of this feeds through to the banks reducing their appetite for market making of corporate bonds.

We infer from RBNZ's lack of interest in the DCM that it is regarded as irrelevant to financial system stability. We beg to differ.

The main point we wish to make in this submission is that a well-functioning DCM which delivers liquidity and efficient pricing is positive for the effectiveness and efficiency of the financial system. It is an outcome RBNZ should recognise as one of its priorities as it undertakes its various regulatory functions. It should not be ignored or, as seems to be happening now, seen as a problem in waiting.

We hope that as you consider the calculation of bank capital requirements, that you reduce the punitive capital requirements allocated to bank holdings of corporate bonds.

We would be pleased to meet with you if you feel a discussion of this topic would be of value.

Yours Sincerely

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Tim Brown

s9(2)(a) privacy [redacted]

Fiona Cameron