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Sent via email: stcproject@rbnz.govt.nz

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Dear Toby

RESIDENTIAL MORTGAGE OBLIGATIONS (RMO)

Thank you for the opportunity to provide feedback on your exposure draft: *Residential Mortgage Obligations (RMO) – Introducing a high grade residential mortgage backed securities framework for New Zealand.* This submission has been written on behalf of SBS Bank and the Co-operative Bank who, at this time, are the only smaller NZ mutually owned banks that currently have single named RMBS structures approved under the existing requirements for RBNZ domestic market operations.

Our responses to the specific questions in the consultation document are included below. Please note that we have not addressed all questions within the document, only those that we have a specific view on. In addition, we make the following overarching comments.

- We acknowledge the work that has been undertaken on these proposals to date and commend the changes made in response to previous submissions, particularly those to align to a more traditional and market accepted RMBS structure.
- Overall, we are supportive of a move to develop a deeper capital market in NZ and recognise that these proposals may also provide issuers and investors an additional term funding & investment instrument. In addition, we acknowledge the benefits that increased standardisation and transparency will bring to the market. We do however continue to have concerns around the high cost of these proposals for smaller bank issuers such as ourselves.
- The existing single name 'internal' RMBS instruments held by us are longstanding, and largely aligned to structures that we have successfully issued into the market. These have been established, and are currently held by us, for contingent liquidity purposes only, as opposed to day to day liquidity management. We believe that these existing bonds will continue to be an important means for the RBNZ to support liquidity access and market stability in times of genuine stress.
- Whilst we appreciate the overall objectives of the RMO proposals, we note that the costs to establish the new RMO structures and the relative rigidity of upfront & on-going operational requirements will favour larger issuances and impose a higher economic cost on small banks relative to the size of their balance sheets. We believe there is a risk that some smaller banks may no longer be able to participate in this market in the short to medium term.

- We have concerns that access to the market at economical pricing may be more challenging for smaller issuers, particularly in the first few years of the new RMO regime. In addition, we note that the currently proposed transition period for transitioning existing structures into the new regime will be particularly challenging for smaller issuers given the scale of work required compared with resourcing levels.
- Accordingly, we would ask that the RBNZ consider the grandfathering of existing structures in their current form for a longer period (at least two years as opposed to six months) to enable adequate time to re-document them or develop alternative contingent liquidity sources. In addition, we ask that the RBNZ consider the introduction of thresholds whereby the transition arrangements around concurrent external issuances are relaxed, or are not applied at all, for example for total issuance levels under say $250m in the short to medium term. We believe that allowing these concessions would make it more attractive for smaller bank issuers to transition to the new regime and, given the relative immateriality, is not likely to compromise the overall policy aims of reducing contingency risks for RBNZ as lender of last resort and supporting the development of deeper capital markets.
- The ultimate development of deeper capital markets is clearly beneficial to all market participants, and we therefore support external market issuance in the long term, however we note that forcing this issuance may create problems with pricing and market acceptance. As smaller issuers this is of particular concern to us. We believe that allowing the market to develop more gradually, would be a more prudent approach.
- We also note that in times of financial instability there is a lower likelihood that external issuance will be able to occur. We assume that under this scenario the RBNZ would relax the current requirements and allow internal RMO issuance.
- Finally, to support the development of deeper capital markets, we strongly recommend that the RBNZ re-considers associated regulatory incentives such as capital relief. Regulatory incentives have proven successful in supporting the development of markets in other jurisdictions such as Australia. We believe that consideration of some form of capital relief to support the objectives of these proposals is appropriate particularly considering the recently announced bank capital proposals.

Responses to questions within consultation paper:

1. ***Do market participants understand the key distinguishing feature of RMO as a high-grade mortgage bond standard? Would the acronym "RMO" present issuers and investors with major disadvantages, as opposed to a different name?***

    - We acknowledge that the mortgage bond standard proposed does create an instrument that is higher quality and more liquid than traditional RMBS, and as such should be labelled differently to enable this distinction. The instrument however is essentially a high quality RMBS with features that enable RBNZ repo eligibility. As such we believe that it is important to use a name that makes this clear to market participants and avoids confusion around associations to other structured securities. We would suggest that using a title such as RMBS-RMO would be more appropriate as this clearly describes the asset class but also provides a distinction from the broader RMBS securitisation market.

2. ***Do market participants agree with the proposal to include more loans for RMO purposes? Is a replenishment subject to the above criteria acceptable?***

    - We support the inclusion of a replenishment clause that enables some flexibility to be added into the structure however believe that a buy back option within the replenishment period should also be included to align with market practice.

6. ***Do market participants agree with the disclosure standard and the Reserve Bank's role in defining and designating a loan level repository for RMBS?***

    - We acknowledge the importance of loan level data in allowing informed funding or investment decisions, however we question the level of loan level data being proposed as this seems to be over and above the typical data requirements needed for similar market transactions.
    - In addition, we are concerned about privacy issues for loan-level data and would propose that any data requirements be strictly limited to those items which are necessary for analytical and valuation

purposes in the context of RMO/covered bonds/RMBS. In particular these requirements should not incorporate any sensitive data and any risks should be mitigated through non-disclosure agreements, redactions, or aggregated reporting. We would expect that any third parties engaged to process and store sensitive data would be able to protect the data and control access at the same standards that a data owner/originator would. This is likely to require robust legal opinions and a transparent design of safe data management processes.

- We note that the capture and reporting of loan level data is complex and often requires inputs from both an originator's front end and back office systems. Creation of new reporting, and/or changes to existing systems is always time consuming and costly. This needs to be taken into consideration as part of the transition arrangements and we would propose that any new reporting requirements are applied progressively with initial requirements being at a stratified table level with detailed loan level data to be introduced progressively. Based on the gaps identified between our current systems and the proposed loan level data template we recommend a transition period of two years. This is to allow time to develop IT and reporting systems, as well as backfill any data gaps. In addition, we recommend that the reporting templates are relaxed to allow for non-provision of data where this is genuinely not available.
- Given the technical and detailed nature of the reporting templates, we would welcome further meetings/discussions on the detailed loan level data requirements before these are finalised.

7. ***Do market participants agree with the functional separation, the disassociation requirements and with the governance framework?***

- We acknowledge the importance of functional separation however we believe that it is important to ensure the right balance is struck so structures are not made unnecessarily complex due to inflexible requirements around separation, disassociation or governance, especially where the same outcomes can be achieved by alternative market accepted means. For example, any requirements for backup servicers or backup swap counterparties should be driven by the market expectations required to support AAA rating requirements as set out by the relevant rating agency. Allowing some flexibility in terms will assist issuers to establish structures regardless of their size or legal structure.
- In addition, we note that current bank statutory management laws can create some issues around enabling separation and, as such, we would encourage any move to expand the current covered bond carve outs in these laws to incorporate these new instruments.

9. ***Do market participants agree to the timing of transitional arrangements and are these considered to be effective to incentivise market placements of RMO?***

- We welcome the inclusion of a transition period, however we believe that some adjustments are required to enable market participants adequate time to transition given the complexity of the new structures proposed and increased data requirements. We also agree that there is a need for a controlled phase-in to provide both issuers and investors alike some time to test the new instruments.
- In particular we note that a time-frame of six months to re-document existing structures will be extremely challenging and recommend that the grandfathering of existing structures in their current form be allowed for at least two years as opposed to six months.
- We also note from the draft loan level data template, that it is expected that all data requirements will be available for new loan originations from 1 July 2019. This assumes that front end origination systems, as well as back office reporting systems will be able to be amended within the next three months. This is not realistic and as noted above, we would recommend that the new reporting requirements be phased in progressively over a longer period of time to enable system & reporting changes to be made. We believe a more realistic timeframe for reporting requirements would be two years, with progressive improvements expected during that time.
- The current NZ securitisation market is small and dominated by non-bank originators. A slew of issuance of high-quality mortgages into a relatively underdeveloped market has the potential to disrupt the status quo for the non-bank sector that relies on securitisation. Furthermore, finding a home for issuance to 'non-regulated' entity investors may be problematic, at least initially while the market is

developing. Whilst we understand the aim of encouraging external issuance to develop the market, we believe that a slower transition of external issuances is preferable so as not to 'flood' the market. We therefore would recommend the level of required external issuance is removed initially and introduced gradually to allow the market to develop more naturally.

- In addition, and as noted in our overarching comments above, we ask that the RBNZ consider introducing issuance thresholds for any transition arrangements, particularly around the concurrent external issuances, to relax, or remove these all together. We believe setting a threshold at levels of issuance under $250m in the short to medium term would make it more attractive for smaller bank issuers to transition to the new regime and, given the relative immateriality, this is not likely to compromise the overall policy aims of reducing contingency risks for RBNZ as lender of last resort and/or supporting the development of deeper capital markets.

We appreciate the opportunity to provide this feedback on your exposure draft and would be happy to discuss any of the items raised as required

Yours sincerely

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