Dear Toby

Submission on the Reserve Bank’s Residential Mortgage Obligations (RMO) Exposure Draft – November 2018 (Consultation Paper)

Kiwibank welcomes the opportunity to submit on the Consultation Paper together with ‘Residential Mortgage Obligations (RMO): (‘RMO Framework’) – Key Terms and Conditions (November 2018)’ (Terms and Conditions) and ‘Residential Mortgage Loan Level Data Template’ published 15 February 2019 (LLD Template).

Kiwibank has been actively involved since 2017 in the industry response to the Reserve Bank on its Review of Mortgage Bond Collateral Standards. Reserve Bank engagement with the issuer and investor community has been well received; it is apparent that many of the concerns raised during that time have been addressed in this latest proposal. In this submission Kiwibank does not seek to reiterate points previously made, rather we raise further matters and points of emphasis.

Responses to selected questions posed in the Consultation Paper are in the attached addendum.

For issuers that need to issue RMO by 30 June 2020, the timeframe and programme of work present real risk. With the policy coming into effect from 1 July 2019 issuers will compete for legal advisors in mid-late 2019 to create transaction documents and must undertake significant technical work to conform to the disclosure requirements. Governance cycles and deal timeline will then follow ahead of June 2020. Alongside that work is the proposed re-work on existing internal RMBS programmes (iRMBS), using the same legal advisers, all within the same timeframes. Given the high quality of portfolios held within iRMBS it is unclear what significant benefit the Reserve Bank will gain from changes to the criteria and disclosure requirements of those programmes. Issuers will be better positioned for a successful implementation if they can focus resources on RMO without the requirement to update iRMBS.

Whilst not covered specifically in the following questions, Kiwibank makes the following comments on certain aspects of the Terms and Conditions:

Section 21. of the terms and conditions states that the maximum percentage of mortgage loans which can be subject to Product Switches, Further Advances, Redraws and Payment Holidays be specified.
This cannot be known at the closing date as any loan in the pool could be subject to, for example, a Further Advance or a Payment Holiday, at any time, at the request of the borrower. The requirement to specify maximum percentages should be removed.

Section 66. of the terms and conditions, ‘Account Management’ states: “The amounts held on trust for the Issuer in the transaction account will be swept at least monthly to the Issuer’s bank account, such that the Issuer’s bank account holds all funds collected as at the monthly sweep date.” This wording needs to accommodate the scenario where the servicer collects funds during a collection period (eg. a calendar month) and then holds onto those funds until the next following payment date (eg. 15th of the month following), noting that funds collected in the days following the end of the collection period and the next payment date will not be transferred on that payment date but will instead form part of the following month’s collections.

Yours faithfully

Tim Main
Treasurer

cc: Malcolm Bruce, Chief Risk Officer
    Geoff Martin, Head of Funding
    Edward McElrea, Securitisation and Funding Manager
    Loretta DeSourdy, Head of Regulatory Affairs
Kiwibank’s Response to Questions:

Kiwibank responds to the following specific questions in the Consultation Paper:

QUESTION 1: Do market participants understand the key distinguishing features 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?

Kiwibank understands the key distinguishing features of RMO. To aid market uptake it could be useful for the Reserve Bank to provide for use by market participants a summary of the key features of RMO vs traditional RMBS.

RMO is a strengthened version of traditional RMBS. Given that key difference it seems sensible that the product name should be unique however offshore market acceptance may be hastened if the product name incorporated ‘RMBS’, eg. RMO-RMBS.

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

Kiwibank agrees that providing issuers with the option of replenishing the underlying loan pool for a defined period is a useful feature. By opting for replenishment an issuer is better able to satisfy any demand by investors for extended tenor.

Kiwibank agrees that, together with an originator’s underwriting policy and criteria, the selection of suitable quality mortgage loans affects the future performance of related RMO securities.

To avoid compromising the value of the eligibility criteria it is important that the meaning of a data item as it is applied to the eligibility criteria is consistently calculated across issuers and well understood by data users. To that end Kiwibank recommends that the data items to be applied to the eligibility criteria be included and referenced in the LLD Template, together with fields specifying the method of calculation where applicable.

The eligibility and portfolio criteria apply at each point that loans are sold into the loan portfolio, including during a replenishing period. Should a breach of any of the portfolio criteria occur through evolution of the portfolio, or through changing environmental data (such as decline in house price indices increasing the ‘Loan Group ID Indexed LVR’ calculation), this will have the unintended consequence of preventing replenishment. A solution would be that any replenishment should be permitted provided it does not worsen an existing breach.

The scalable goal of the Reserve Bank will be best met if the volume of loans available for RMO is high. Anecdotally the very low level of losses sustained by Kiwibank on its home loan portfolio over time supports the notion that it is high quality. Accordingly, portfolio criteria should not materially restrict Kiwibank from selecting loans that are representative of its total home loan portfolio. This will have the added benefit of avoiding ‘cherry-picking’ of loans which would disadvantage other creditors of Kiwibank.
**NZ Citizen or NZ Resident.** Kiwibank queries why this is included as a loan level criterion. From an enforcement perspective provided that a securing property is in NZ a mortgagor can enforce his/her rights through, among other methods, the appointment of a receiver, regardless of the citizenship or residency status (or indeed location) of the borrower. It would be consistent with eligibility criteria applicable to NZ covered bond programmes if, instead of 'NZ Citizen or NZ Resident', that the criterion was 'Secured by a Mortgage over Land which is a residential or housing property', where 'Land' means property in NZ.

The inclusion of this as a criterion presents practical problems as well. Kiwibank captures citizenship and residency information of borrowers at the point of loan application. Capturing this data has only been a requirement in recent years. If this criterion was to apply to all loans regardless of origination date it would significantly reduce the pool of loans eligible for RMO. Kiwibank suggests that, if at all, this criterion is implemented only to the extent that data is available. ‘Borrower Residency Status’ can be reported in the LLD Template in accordance with the template requirements (ie. ND1, data is not reported if it was not collected at the time of origination AND loan was originated prior to 1 Jul 2019).

**Loan Level Indexed LVR.** The LVR calculation applied to this criterion should be that defined in the LLD Template (ie. field ‘Loan Group ID Indexed LVR’).

**Investment or Interest Only Loans.** The definition of ‘Investment Loan’ applied to this criterion should be those defined in the LLD Template (ie. field ‘Main Security Property Occupancy Type’ for Investment; and ‘Loan Payment Type’ for Interest Only). It is not clear to Kiwibank why these criteria are combined and not monitored separately. Is there evidence to show they are equally indicative of loan quality?

Kiwibank also notes that the Terms and Conditions include the following eligibility criteria:

*i) mortgage loans where the obligor has made all scheduled interest payments due and payable over the last 90 days

*g) mortgage loans that are not in default*

Assuming that the definition of ‘default’ is that defined in the LLD Template field ‘Principal Balance in Default’ (ie. over 90 days in arrears) then criterion g) seems redundant given criteria i). Kiwibank suggests that eligibility criteria i) be reworded to “*i) mortgage loans where the obligor has made all scheduled at least one interest payments due and payable over the last 90 days*,” which is in line with criteria on Kiwibank’s covered bond programme and deals with the risk regarding an obligor’s tendency to pay. That change would then mean criteria g) is no longer redundant.

Kiwibank does not agree that the specified criteria should apply to iRMBS. Kiwibank considers that its iRMBS portfolio is already high quality and the application of revised eligibility criteria will not result in any meaningful improvement in portfolio quality; further the perceived benefit of such changes will erode to zero during the transition period as the repo limit for iRMBS reduces. Such a work programme will distract issuers from a successful implementation of a RMO programme.
QUESTION 3: Do market participants agree that the minimum subordination provides enough credit loss protection for the senior notes? Is the further credit enhancement derived from a write-off test sufficient to reduce price volatility in RMO senior notes?

Kiwibank notes that the proposed 10% subordination (or greater if required by rating agency) exceeds what is typically seen in RMBS in the well performing Australian market. On that basis it is not expected to constrain investor demand.

QUESTION 4: Do market participants agree that the proposed structures allow to utilise RMO senior and mezzanine notes better compared to the initial proposal?

Kiwibank considers that the current proposed structure is more useable from an issuer perspective than the initial proposal and does not compromise attractiveness to investors.

QUESTION 5: Do market participants agree that the utilisation, the Depository and haircuts provide RMO holders with sufficient flexibility to decide on their best use?

Yes. In addition to being a funding mechanism for banks Kiwibank agrees that there is sufficient flexibility in the proposed use of RMO, including by a regulated bank as part of its portfolio of liquid assets.

QUESTION 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?

Kiwibank agrees with the requirement to produce investor reports and with the proposal to define a LLD Template. A LLD Template which requires reporting of a minimum set of data and which contains clear definitions and data formats will support comparability of transactions.

A ‘minimum viable product’ approach to defining the LLD Template and the associated technical requirements for disclosure will provide issuers with the best chance to implement required technical change in the proposed transition timeframe. Thereafter any further enhancements to disclosure requirements should only be implemented when the associated benefit is clear, and the users of the data are well understood. It would be a fraught and onerous approach to define a comprehensive disclosure template at the outset to attempt to satisfy potential needs of an assumed set of users.

Consideration should be given to a process for market participants to request fields be added to the LLD Template to accommodate future developments, for example to classify loans as qualifying as ‘Green’ or ‘Social’.

The LLD Template requires that loans which have been removed from the portfolio, and loans which have been fully repaid, continue to be included in the template (albeit reporting a reduced set of data). This is a departure from the way that Kiwibank currently reports on securitised portfolios, where only loans currently in the portfolio are included. Requiring this change will impose additional technical work on issuers within already challenging timeframes and heighten the risks threatening a successful
implementation of RMO. Kiwibank suggests that this be a ‘stage 2’ requirement, providing issuers with the flexibility to deprioritise this work depending on complexity.

**Data Repository**

Whilst the aggregating capability offered by a loan level data repository would benefit the Reserve Bank it is unclear what significant benefit this may offer other market participants which could not be achieved through other means. Ahead of an issuance an issuer will prepare and disclose information, for example in an Information Memorandum. If loan level data was to be provided at that time it would be as part of that Information Memorandum and would be provided equally to all potential investors outside of any data repository. Post issuance performance reporting will be provided by way of investor reports made available by the issuer, potentially supplemented with loan level data in an agreed format (such as the LLD Template).

**Sensitive Data**

Banks are only able to report data to the extent that privacy laws and banks’ duty of confidentiality are being complied with. Non-Disclosure Agreements between a bank and a recipient of information do not necessarily relieve a bank of these obligations. Accordingly, Kiwibank considers that it can only provide data to a repository to the extent that it is not ‘customer data’. ‘Customer data’ would include data such as borrower income, and any data which could result in a customer being identifiable (such as too specific a postcode, combined with property valuation and loan start date; for example).

‘Fixed Interest Rate Expiry Date’ – is considered commercially sensitive. Periods with high volumes of fixed rates expiring could be used by competitor banks for targeted marketing campaigns. If this data item must be reported Kiwibank suggests it be reported by calendar quarter rather than specific date.

In addition to withholding any data required to comply with NZ Law, any requirement for an issuer to publish LLD Template data on its website would need to be subject to withholding sensitive data. Pending the establishment of any data repository, issuers are unlikely to be able to implement a system within the transition timeframe to control the dissemination of differing levels of data to subscribers based on subscriber type.

**LLD Template – comments on certain fields**

Loan Redraw Feature Flag – field description should not refer to ‘Scheduled Loan Balance’ as that field is not in the LDD Template.

Main Security Property Metro Flag – Ideally a consistent method of determining this data item would be applied across issuers. It could be that each issuer determines this field based on postcode (a potentially complex and extensive exercise) or is able to source this from a data provider. The prescriptive field description is helpful in that it would assist consistency across issuers, however if the definition deviates from a definition applied by a data provider it could preclude using that provider as a data source. A simpler field description may therefore be appropriate, such as ‘Metro – the property is located in a metropolitan area’; and ‘Non Metro – the property is not located in a metropolitan area’. 
Primary Borrower Methodology – ‘primary borrower’ may be determined by an originating bank by means other than income levels. Field description for ‘Other’ should reflect this as an option, for example ‘Other - information other than income level is used to determine the primary borrower’.

Primary Borrower First Home Buyer – ‘First Home Buyer’ is a data item that has not always been collected for borrowers; ND1 should be an option for this data item.

Primary Borrower Residency Status – As noted above citizenship and residency status have only been collected in recent years; ND1 should be an option for this data item.

Loan Underwriting Standard – Whilst Kiwibank appreciates the rationale behind this field we query whether it will be meaningful given the field description. The meaning of ‘overrides in the credit process’ will mean different things to different originators; for example, those which have a largely manual review process vs those which have a sophisticated automated credit scoring process.

Full Primary Borrower Recourse – the field description means that guarantees provided by parties other than the primary borrower will not be included. Is that the intention?

Applicable Arrears Methodology – the field description contains the word ‘(recommended)’, which should be removed.

Principal Balance in Default – default amounts are typically reported at a loan level, not at the Group ID level. Kiwibank suggests that references to Group ID be removed from the field description.

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

Yes, however, Kiwibank notes that the backup servicer function is a new requirement in NZ and it is unclear at this stage who in NZ could fill this role; this will be a hurdle to setting up an RMO programme.

QUESTION 8: Do market participants agree that the proposed requirements make the preliminary assessment more efficient and transaction standards more comparable? To what extent will a Master document help to reduce legal due diligence costs?

Kiwibank agrees that a reasonably harmonised documentation standard will aid efficiency and understanding in the market, particularly for parties which perform roles for multiple transactions. Any documentation standard should be sufficiently flexible so as not to cause inefficiency itself, for example, not force an issuer to populate irrelevant sections.

Kiwibank expects that as part of bringing an RMO transaction to market that the information required in a Master Document as set out in the Consultation Paper would be provided to potential investors in any case, so the requirement for a Master Document is unlikely to materially affect costs, including legal due diligence costs.
QUESTION 9: Do market participants agree to the timing of transitional arrangements and are these considered to be effective to incentivise market placements of RMO?

iRMBS
The requirement to update iRMBS will consume considerable resource at banks and put at risk a successful RMO implementation. Leaving iRMBS unchanged will allow banks to give their full attention to the development of the RMO programmes. Given the high quality of existing iRMBS portfolios it is unclear what significant benefit the Reserve Bank will gain from changes to the criteria and disclosure requirements of those programmes.

If adoption of disclosure obligations does remain a requirement for iRMBS, it is implicit that the technical change required to support that needs to be in place by 31 December 2019. Given finite technical capacity at banks (alongside competing priorities) that is a very challenging timeframe for banks, even if all technical requirements are clear by 1 July 2019. Kiwibank suggests that any disclosure requirement be required for 30 June 2020 at the earliest.