RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

APPENDIX A

Review of mortgage bond collateral standards

Summary of submissions to questions

Please note:

This summary reflects the understanding of Reserve Bank staff of what submitting parties had in mind when formulating their responses to the policy part of the consultation. To avoid redundancy in responses to answers in the consultation, the authors have re-arranged some content between certain questions. The authors trust this allows for a better readability.

August 2019

APPENDIX 1 – Summary of Questions and Answers from submissions

Section	RESIDENTIAL MORTGAGE OBLIGATIONS (RMO) FRAMEWORK
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 disadvantages, as opposed to a different name?**
Investors	Investors appreciate the effort made to simplify the framework and bring it closer to conventional mortgage backed securities while preserving the benefits of standards. While RMO as a technical term would be familiar now to domestic investors, it would be less familiar to offshore investors, a different name (e.g. RMO-RMBS) could help.
Issuers	While RMO remain an RMBS product, their difference to conventional RMBS lies in the formalisation of the standards and capital structure becoming repo-eligible criteria. Given that RMO are essentially RMBS it would be preferable if the final name of the standard would carry an RMBS reference to avoid misperceptions of product features.
Other	The implementation of the new standard is generally seen as a positive move in trying to establish deeper markets and a broader product variety.
2	**Do market participants agree with the proposal to include more loans for RMO purposes? Is a replenishment subject to the above criteria acceptable?**
Investors	The portfolio guidelines have not changed much since the prior proposal and would still guarantee a high quality portfolio at the closing date which then evolves over time. The flexibility to issue replenishing RMO is acceptable, however, in practice it could be expected this is initially more suitable for domestic rather than offshore investors, as the risk assessment requires a detailed knowledge of the New Zealand economy.
Issuers	The portfolio guidelines remain similarly prescriptive and could limit issuance activity. Some banks thus suggest to further relax on the portfolio guidelines, include non-NZ residents, student and work visa holders, and be less restrictive on the amount of investor lending in the mortgage pools. Some smaller regulated entities think that the burden of the new regime could be relatively high, as their loan portfolios were less reflective of the average across the system underlying the RMO policy proposal. Some banks note it should be clearer, how the criteria could be adjusted in a crisis situation.
Other	There were no specific comments from both a structuring and operational perspective.
3	**Do market participants agree that the minimum subordination provides enough credit loss protection for senior notes? Is the further credit enhancement derived from a write-off test sufficient to reduce price volatility in senior notes?**
Investors	Given the portfolio guidelines provide for a high quality portfolio, the minimum proposed subordination provides an acceptable credit loss protection for senior notes. One aspect to consider is that rating agency criteria could change in the future requiring more than 10% subordination for some transactions. Dual reference to the higher of either 10% subordination or what a AAA rating requires remains key. Additional subordination derived from a write-off test will not necessarily imply that

	price volatility is reduced but volatility depends on whether markets consider the actual subordination level as sufficient to buy and hold the securities until maturity, if required.
Issuers	The level of 10% subordination appears to be more than adequate, in light of the number of constraints to control the quality of the securitised portfolios. Some banks suggest the subordination level should only be determined by the credit rating agency and no floor be given by the RBNZ. Other banks remark the minimum level of risk retention proposed was still significantly higher than in other jurisdictions, even though New Zealand does not generally follow an "originate and distribute" mortgage banking model (which could impact negatively on the average credit quality). Credit quality was not the sole determinant of price volatility and other factors (eg relative value) could impact on pricing over time, limiting benefits of additional enhancements.
Other	No specific comments were made.
4	**Do market participants agree that the proposed structures allow to utilise RMO senior and mezzanine notes better compared to the initial proposal?**
Investors	While the structural flexibility implied is positive this feature might be overvalued as in the beginning investors might not have great appetite for longer dated tranches of senior notes and there is domestically a lack of demand for mezzanine notes. Other prescriptive features might be too narrow to tailor structures to specific investor demands (such as the 2% minimum thickness for mezzanine tranches). Overall, the standardisation sought, remains a policy trade-off and implies benefits and costs.
Issuers	The proposed structure is an improvement on the initial proposal but is still inflexible. It would be overly optimistic to go from an underdeveloped market to issuance volumes consistent with a mature market. However, the transition could become easier if the capital structure was flexible to meet investor demand in changing market conditions. It was unclear how section 73 of the term sheet could work in practice which in principle allows issuers to approach RBNZ for approval of an alternative RMBS structure.
Other	No specific comments.
5	**Do market participants agree that the utilisation, the Depository and haircuts provide RMO holders with sufficient flexibility to decide on their best use?**
Investors	No specific comments.
Issuers	Some banks mention that NZ Clear was the RBNZ standard for NZD transactions but that it was likely that non-NZD issuance would emerge and non-NZD RMO would need to be cleared through an offshore clearer (eg Euroclear). The terms and conditions should include respective references. The pre-approval of programs is regarded as sensible, however, some issuers are doubtful of the capacity of the RBNZ to process individual issuances as fast as might be required to go to the markets.
Other	No specific comments.
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?***
Investors	Disclosure is very important to give the market confidence in the RMO product as it allows an independent analysis and ongoing risk monitoring without the reliance on

	rating agencies or other third parties. The requirements proposed are similar to those in other jurisdictions, so investors are increasingly used to having such data available.
Issuers	Some banks note there are still some inconsistencies in the definitions used in the terms and conditions and the definitions used in the loan level data template. It was important to delay any delivery of data until the scope of data and the definitions were reasonably robust. This was paramount to minimise costs and effectively implement the system changes required. Some banks note they do not collect certain information asked for in the template and would require a longer period for the information to be collected and to become processed in reports. In general any information to be delivered in the loan level data template had to be legal to be provided to a third party under the new privacy legislation. Interested parties as named in the terms and conditions should thus be limited to parties to whom the issuer may legally provide such information. Availability for some of the data should be considered as voluntary and the template should provide optionality to opt out of some of data. There remain security concerns if data has to be provided to a third party repository. The preference would be to providing data to investors via access to an issuers own portals and other than that only to upload data to the Reserve Bank's system directly.
Other	No specific comments.
7	**Do market participants agree with the functional separation, the disassociation requirements and with the governance framework?**
Investors	The functional separation, disassociation of assets and liabilities as well governance reflect sound standards for operating a secured funding scheme. Some aspects (like nominating a back-up servicer) might be new to New Zealand. However, they provide more transparency as to what fall-back procedures would look like in a small market.
Issuers	The disassociation requirements and governance frameworks are agreeable in so far as they are typical for securitisation purposes. The value added of a back-up servicer is limited in the New Zealand context, and the Reserve Bank is considered to have sufficient control over the processes and organisational options in a default scenario. Overall, there remain a number of grey areas in current legislation, once improved could benefit offshore participation and support the development of deeper markets. This is specifically the case for the legislative reforms needed to provide more certainty on bankruptcy remoteness of assets that are carried by funding SPVs. There was still room to improve on the cost of these securities, e.g. by providing the flexibility to trusts to arrange the liquidity facility directly with the originator, or, by removing the requirement to arrange for back-up servicing commitments before a default occurred.
Other	The role of trustees in the functional separation outlined should become reasonably specified with regard to the day-to-day duties and compliance with a revised trust law. The Reserve Bank should engage with the relevant ministries to ensure consistency.
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 costs?**
Investors	Most certainly the proposed standards would make the products more comparable. If a harmonisation of documentations could be achieved this could help to make issuance efficient for investors. Not having to do as much due diligence on new issues,

	or not having to adjust their analytical models for every structure again, could help to reduce transaction costs while improving comparability and relative value.
Issuers	There is currently an uncertainty what the proposed Master Document would entail. In general each issuer should be allowed to follow its required documentation standards, as long as the terms and conditions provided in the framework were fulfilled.
Other	No specific comments were made.
9	**Do market participants agree to the timing of transitional arrangements and are these considered to be effective to incentivise market placements of RMO?**
Investors	One of the key issues remains whether the proposed 15% market placement during the transition period meets sufficient market appetite, if it is to be fulfilled over a compressed time period. The residual amounts could require some offshore investor participation. How stable this offshore demand is will depend on a number of factors.
Issuers	The current proposed timetable presents regulated entities with high operational and market risks and should thus be reviewed to ensure an orderly transition process. A situation where several market participants try to enter the market in too short of a time frame could create unintended pricing pressures. To avoid that the Reserve Bank should take a more medium term view with regard to developing a market. Operational preparation will take some time and it was in the interest of all market participants to avoid undue risks being triggered by a too ambitious transition process. During that period I-RMBS should remain eligible and the limits for I-RMBS should only start to reduce after a sufficiently long test period for RMO being a minimum of two years. If RMO would not trigger sufficient investor appetite outside the banking sector, their structure might need to be reviewed and adapted. While issuers would do their bit to ensure transition targets can be met, the Reserve Bank would need to ensure markets of its own availability to process RMO approvals. Overall, a more flexible transition was more feasible for financial stability targets and a sustainable market development.
Other	Given that there are many small changes involved in bringing an RMO product to the market, the timing should be reconsidered and provide certainty as to the deliverables.