



# Westpac New Zealand Limited

Submission to the Reserve Bank of New Zealand: Residential  
Mortgage Obligations (RMO)

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## 1. INTRODUCTION

### Introduction

1.1 This submission to the Reserve Bank of New Zealand (**RBNZ**) is made on behalf of Westpac New Zealand Limited (**WNZL**). This submission is a response in relation to the "Residential Mortgage Obligations (RMO) – Introducing a high grade residential mortgage backed securities framework for New Zealand" exposure draft dated November 2018 ("**RMO Paper**").

1.2 WNZL's contact for this submission is:

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1.3 We would welcome further engagements on this consultation, including the opportunity to present oral submissions in person to the RBNZ.

### Executive Summary

1.4 We welcome the opportunity to provide feedback on the RMO Paper. WNZL has participated in a joint bank submission alongside other major New Zealand issuing banks. This separate individual WNZL response is intended to sit alongside that joint submission and seeks to highlight our three key concerns within the RMO Paper, as well as other issues.

1.5 We remain supportive of the development of local capital markets, including a New Zealand RMBS market in a form that is acceptable and familiar to investors (domestic and international), issuers, and the RBNZ.

1.6 We consider the 2018 proposal to be a significant improvement over the 2017 proposal. However, material issues remain that are either inconsistent with the RBNZ's financial stability role, the stated goals of the project, or existing statutes.

### Background

1.7 In July 2016, the RBNZ engaged New Zealand banks to begin a process to re-evaluate existing internal securitisation structures and provide a more robust framework to assist in New Zealand banks' contingent funding sources.

1.8 Subsequently over 2017, the RBNZ continued consulting with banks on proposals that would ultimately be presented for consultation in November 2017. Following a further period of engagement with market participants, the RBNZ released the RMO Paper and the Key Terms and Conditions dated November 2018.

1.9 The RBNZ has continued to consult with the market over late 2018 in respect of the draft loan level data (LLD) reporting requirements.

**Overview**

1.10 Our submissions in this document are structured as follows:

- (a) Section 2: Pro-cyclicality of Residential Mortgage Obligation (RMO) proposal;
- (b) Section 3: Implementation Timing;
- (c) Section 4: Loan Level Data (LLD) requirements; and
- (d) Section 5: Other Material Requirements.

**2. PRO-CYCLICALITY OF RESIDENTIAL MORTGAGE OBLIGATION (RMO) PROPOSAL**

2.1 The proposal set out in the RMO Paper requires at least 15% of the senior notes in a transaction to be placed with non-regulated entities. We submit that this is inconsistent with the RBNZ’s stated goal of scalability, since funding markets (including RMO) would potentially be dysfunctional or closed to banks in the crisis. This would render RMOs as ineffectual as a funding instrument at the time that the funding is most critical. In such circumstances the RBNZ would be forced to ‘signal’ the crisis to the market by removing the 15% requirement if required to act as lender of last resort to maintain financial stability.

2.2 [REDACTED]

2.3 The RBNZ endeavours to achieve price transparency for repurchase activity through externalisation of RMO. We consider that the RBNZ will best support and develop liquidity by not differentiating between regulated and non-regulated investors. Total RMO exposure in each bank’s liquidity portfolio can be capped in BS13 Annex A, managing cross-bank holdings in the same manner as bank securities holdings are currently managed.

2.4 It is in the banks’ long term interests that a broad array of investors outside of the immediate banking market is developed.

- 2.5 The RMO proposal requires continuous primary market activity due to the limited reinvestment period, constraining banks' ability to meet investor demand and shortening duration in the funding book. The limited flexibility presented in the RMO proposal may undermine financial stability by increasing banks' exposure to funding markets. These issues are easily addressed through increasing structural flexibility available under RMO and will afford the market the best opportunity to develop.
- 2.6 In summary our position is that the RBNZ is best placed to provide the market sufficient structural flexibility by not limiting the reinvestment period in RMO to encourage natural market development, and without differentiating between potential buyers, noting that over-all cross bank holdings be managed at a BS13 Annex A level.

### 3. IMPLEMENTATION TIMING

- 3.1 Typically, transitional arrangements occur by grandfathering and reducing benefits over a period of time. The current proposal is that the internal RMBS be restructured, re-documented and meet disclosure requirements within six months, before grandfathering the structure over five years. As noted below at 4.3, we are cautious that the RBNZ STC Project Team may not fully appreciate the scale of the data task. We expect that such a data project will take approximately two years to complete. We further note that the LDD data template is not finalised.
- 3.2 The timeframes set out in the RMO Paper are ambitious. There are inherent risks in these ambitious timeframes, and we have not been provided with rationale to justify the risks. This is particularly relevant where the proposed transition period is to take place alongside competing and similarly critical projects such as: the capital review, BS11, BS13 Review, Initial Margin, EU Benchmarking Project, and the LIBOR Replacement Projects.
- 3.3 The RBNZ is also in the process of consulting on material changes to the regulatory and financial stability framework. These changes are relevant, but not considered in the RMO Paper proposal. We submit that the proposal set out in the RMO Paper is materially incomplete without taking into account the implications of the capital and Reserve Bank Act consultations on depositor protection (insurance and preference).
- 3.4 [REDACTED]
- 3.5 Overall we consider that the proposed transition period is unworkable in its current form, creating unnecessary risks to bank funding and financial stability. We propose that instead:
- (a) Existing internal RMBS be transitioned without time limit or LLD reporting requirements until a local RMBS market can develop and becomes a functional source of funding;

- (b) A legislative framework for RMO be created to assist market development; and
- (c) LLD reporting requirements are developed separately and introduced as per 4.5 below.

**4. LOAN LEVEL DATA (LLD) REQUIREMENTS**

4.1 We engaged with the RBNZ on the initial LLD proposal via the workshops held in late 2018, and also as part of a working group that was set up. The purpose of the working group was twofold:

- (a) First, to produce a LLD template based off the internationally accepted data in the banks' stratified covered bond reporting.
- (b) Second, to overlay New Zealand investor requirements in order to meet the RBNZ's stated goal: reporting that allows investors to make 'informed funding or investment decisions and price risks and returns in RMO efficiently'.

4.2 In February 2019, the RBNZ released a revised LLD template that expanded the required data provision beyond what issuers and investors have advised the RBNZ is required for 'informed funding or investment decisions and price risks and returns in RMO efficiently.' We submit that the expanded data request is extraneous, and not reflective of what is required for the efficient evaluation of risks in a 'High Grade RMBS' supported by a 'higher quality mortgage loan portfolio'. We have not been provided with any supporting analytical justification or cost-benefit analysis.

4.3 As indicated above at 3.1, we are cautious that the RBNZ STC Project Team may not be fully aware of the scale or complexity of the data reporting task presented to the banks. This has been indicated by certain data requests for items that are in excess of those required by other offshore jurisdictions and the investor market has considered unnecessary.

4.4 [REDACTED]

4.5 [REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

## 5. OTHER MATERIAL CONSIDERATIONS

5.1 One of the primary goals the RBNZ articulated to us in 2016 (in the initial consultation phase of the RMBS review) was the creation of a legislative RBMS solution akin to that of covered bonds. While this solution is not confirmed in the RMO Paper, we support such a solution, given that it would provide certainty to offshore investors in normal markets but, critically in a crisis. Also, the only non-equity exposures that APRA will allow above the 5% exposure cap are registered covered bonds, as covered bonds are legislated outside of the OBR regime. In not pursuing this legislative solution, the RMO proposal is compromised in providing an uplift in contingent funding sources available to NZ banks through their respective Australian parents.

5.2 The proposed RMO standard also considers a number of features that are inconsistent with the requirements of APRA APS120, such as aspects of the call and loan repurchase functionality. As major NZ banks have Australian parents (including WNZL), these entities may not be able to use structural features which do not comply with APS120.