

Liquidity Policy

Annex: Liquid Assets

Prudential Policy Department
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Liquid assets

1. This Annex defines primary and secondary liquid assets for the purpose of calculating the one week and one month mismatch ratios as required by the Reserve Bank's liquidity policy.
2. **Primary liquid assets** contain the following classes of assets:
 - (a) Exchange Settlement Account balances held at the Reserve Bank (no haircut);
 - (b) New Zealand dollar denominated notes and coins held by the registered bank and demand balances with other New Zealand registered banks (no haircut);
 - (c) foreign currency notes and coins held by the registered bank, and foreign currency demand balances held with overseas banks, subject to a five percentage point haircut;
 - (d) New Zealand government securities denominated in New Zealand dollars, with the corresponding haircuts listed in Annex 1; and
 - (e) other securities as listed in Annex 1, with the corresponding haircuts listed in that annex.
3. **Secondary liquid assets** contain the following classes of assets:
 - (a) securities as listed in Annex 2, with the corresponding haircuts listed in that annex.
4. Assets in the above lists may only be included as primary or secondary liquid assets if they are unencumbered, that is, they are not pledged either explicitly or implicitly in any way to secure, collateralise or credit-enhance any transaction, and are not held as a hedge for any other exposure; except that assets which have been pledged to the Reserve Bank but are not utilised may be included as liquid assets.
5. Cover factors (also known as "risk margins" and "haircuts") which apply to each class of security included in liquid assets are detailed in Annex 1 and Annex 2.
6. The haircuts listed for corporate securities, asset-backed securities, and bonds issued by registered banks include a 5% additional margin to reflect the fact that the markets for these instruments are typically neither very deep nor liquid. (These haircuts are highlighted in bold italics in the attached.) The Reserve Bank may agree that the registered bank can remove the 5% add-on for a particular security, if the bank provides good evidence that it is frequently traded.
7. In place of the standard cover factors listed in the attached Annexes, the registered bank may apply the following cover factors to any security held by the bank which matures within the time horizon of the respective mismatch ratio calculation:
 - (a) Securities denominated in New Zealand dollars: 0%.
 - (b) Securities denominated in a foreign currency: 5%.

8. The eligibility and cover factor of a given issue of securities depend on the credit rating of that issue (rather than the rating of its issuer). The credit ratings provided in Annex 1 and Annex 2 are Standard and Poors' ratings. Credit ratings by other acceptable ratings agencies which are broadly equivalent to the S&P ratings are to be allocated to the corresponding S&P rating.
- 8A. As an interim measure from December 2011, the following approach must be used to determine the eligibility and cover factor for any issue of "Kauri" securities (New Zealand dollar denominated securities issued by overseas sovereign, supranational and quasi-sovereign entities):
 - (a) to be eligible, the security must be rated at least AA- (or its equivalent) by at least two acceptable rating agencies, and if it is rated by three or more rating agencies, no more than one of those ratings may be lower than AA- (or its equivalent); and
 - (b) the cover factor for an eligible Kauri security is the cover factor listed in Annex 1 corresponding to the security's lowest (least favourable) rating.
- 8B. Until further notice, for the categories of securities listed in Annexes 1 and 2 other than Kauri securities, a bank may determine the eligibility and cover factor of an issue of securities by reference to the issue's highest (most favourable) rating.
9. For avoidance of doubt, types of security such as floating rate notes and subordinated debt, which may not be eligible in the Reserve Bank's Domestic Market Operations, are eligible as liquid assets provided they fall into one of the issuer and rating categories in the attached.
10. Other than foreign currency denominated securities specifically referred to in the attached, all securities must be denominated in New Zealand dollars.
11. In Annex 2, **registered bank securities** means securities issued in registered form by a bank, where the bank is either a New Zealand-registered bank or an equivalent overseas-incorporated entity, that is, an entity carrying on banking business with authorisation, licence or similar permission from a banking supervisory authority in its country of incorporation. In line with paragraph 10, this only includes New Zealand-dollar-denominated securities.
12. The following **eligibility limits** apply:
 - (a) The limit for eligibility of all residential mortgage-backed securities (including covered bonds) held by the registered bank across all issuer names, after applying the haircuts, is the percentage of the bank's total assets specified in the table below, in accordance with the bank's encumbrance ratio (encumbered assets over total assets).

Encumbrance Ratio (%)	0 - 16	>16 - 17	>17 - 18	>18 - 19	>19 - 20	>20
Residential Mortgage Backed Securities (including covered bonds) - Mismatch Ratio Eligibility (%)	5	4	3	2	1	0

- (b) The limit for eligibility of total RCDs issued across all names held by the registered bank, after applying the haircuts, is 2% of the bank's total assets.
- (c) For the purpose of these limits, total assets is the figure as reported in the monthly Bank Balance Sheet Survey (DS summary) for the month that is two months prior to the BS13 reporting month (e.g. the January Bank Balance Sheet Survey figure for total assets would be used when calculating eligibility limits for March BS13 reporting).
- (d) If the bank provides a back-up liquidity line covering more than 50% of a particular issue of asset-backed securities, that issue must not be included in the bank's liquid assets.
13. An asset is considered encumbered if it has been pledged to secure, collateralise or credit enhance any transaction in favour of another party, and from which it cannot be freely withdrawn. Encumbered assets included in the calculation of an encumbrance ratio include the higher of the fair value and the settled value for: assets backing pledged i-RMBS, assets in pools supporting covered bonds, and other assets granting security interests to creditors such as warehouse facilities, government bonds and other securities used as collateral, OTC derivatives including initial margin, cash reserves and daily collection accounts, and any securitisation related over-collateralisation requirements.

Annex 1 – Primary liquid assets				
Class	Security	Credit rating	Cover factor (“haircut”)	
			maturity	
			< 3 years	≥ 3 years
			(per cent)	
New Zealand government securities				
	Treasury bills	see footnote *	1	-
	Bonds	see footnote *	1	3
	Inflation-indexed bonds	see footnote *	1	3
Reserve Bank of New Zealand				
	RB bills	n/a	1	-
LGFA and Local authority securities				
	Commercial paper†	A-1+	10	-
		A-1	15	-
		A-2	20	-
	Bonds	AAA	5	8
		AA- to AA+	8	10
		A- to A+	10	15
		BBB- to BBB+	15	20
Qualifying Crown Agents**				
	Commercial paper†	A-1+	10	-
		A-1	15	-
		A-2	20	-
	Bonds	AAA	5	8
		AA- to AA+	8	10
		A- to A+	10	15
		BBB- to BBB+	15	20
State owned enterprises				
	Commercial paper†	A-1+	10	-
		A-1	15	-
		A-2	20	-
	Bonds	AAA	5	8
		AA- to AA+	8	10
		A- to A+	10	15
		BBB- to BBB+	15	20
“Kauri” securities‡				
	Commercial paper†	A-1+	10	-
	Bonds	AAA	3	5
		AA- to AA+	6	8
		A- to A+	10	15
Residential Mortgage-Backed Securities (including “covered bonds”)				
Two name basis	Commercial paper†	A-1+	10	
	Bonds	AAA	5	8
Single name basis	Commercial paper†	A-1+	19	19
	Bonds	AAA	19	19
† Commercial paper securities are discount securities with maturities of 365 days or less.				
‡ Kauri securities are NZD securities issued by overseas sovereign, supranational and quasi-sovereign entities.				
* The acceptable ratings are the domestic currency sovereign ratings for New Zealand, short-term or long-term as applicable.				
** For a list of Qualifying Crown Agents, please refer to the list maintained on the Reserve Bank webpage .				

Annex 2 - Secondary liquidity assets				
Class	Security	Credit rating	Cover factor ("haircut") ‡	
			<i>maturity</i> < 3 years	≥ 3 years <i>(per cent)</i>
Securities guaranteed by the NZ government				
	Commercial paper†	see footnote *	10	-
	Bonds	see footnote *	5	8
Securities guaranteed by AAA rated sovereign entities				
	Commercial paper†	A-1+	10	-
	Bonds	AAA	5	8
Foreign currency denominated securities guaranteed by the NZ government				
	Commercial paper†	see footnote *	15	-
	Bonds	see footnote *	13	15
Foreign currency denominated securities, issued or guaranteed by AAA rated sovereign entities, or issued by AAA rated supranationals				
	Commercial paper†	A-1+	15	-
	Bonds	AAA	10	13
Local authority securities				
	Commercial paper†	< A-2 and unrated	25	-
	Bonds	<BBB- and unrated	25	30
Corporate securities				
	Commercial paper†	A-1+	15	-
		A-1	20	-
		A-2	25	-
	Bonds	AAA	10	13
		AA- to AA+	13	15
		A- to A+	15	20
		BBB- to BBB+	20	25
Asset backed securities	<i>(ineligible if the bank is the liquidity provider for more than 50% of the issue)</i>			
	Commercial paper†	A-1+	15	-
		A-1	20	-
		A-2	25	-
	Bonds	AAA	10	13
		AA- to AA+	13	15
		A- to A+	15	20
		BBB- to BBB+	20	25

Annex 2 - Secondary liquidity assets (cont'd)				
Class	Security	Credit rating	Cover factor ("haircut") ‡	
			maturity	
			< 3 years	≥ 3 years
			(per cent)	
Registered bank securities				
	Registered Certificates of Deposit (RCDs)†	A-1+	10	-
		A-1	15	-
		A-2	20	-
	Bonds	AAA	<i>10</i>	<i>13</i>
		AA- to AA+	<i>13</i>	<i>15</i>
		A- to A+	<i>15</i>	<i>20</i>
		BBB- to BBB+	<i>20</i>	<i>25</i>
‡ haircuts shown in bold italics include 5% additional margin to reflect lower liquidity (see introductory notes)				
† Commercial paper and RCD securities are discount securities with maturities of 365 days or less.				
* the acceptable ratings are the current sovereign ratings for New Zealand, short-term or long-term, and for domestic currency or foreign currency, as applicable				