



Consultation Document: Covered bonds application process and information requirements

Consultation Document

The Reserve Bank invites submissions on this consultation document by November 16th 2012.

Submissions and enquiries should be addressed to:

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Please note a summary of the submissions may be published. If you consider that any part of your submissions should properly be withheld on the grounds of commercial sensitivity or for any other reason, you should indicate this clearly.

October 2012

SECTION 1: INTRODUCTION

- 1 The Finance and Expenditure Select Committee has reported back to the House of Representatives on the Reserve Bank of New Zealand (Covered Bonds) Amendment Bill ('the Bill'). Assuming the Bill passes into law, the Reserve Bank will be required to maintain a public register of covered bond programmes. There are a number of matters that need to be specified in order to implement the law, these are:
 - the application process;
 - the information registered banks are required to provide to the Reserve Bank;
 - whether programmes may be registered under specified asset class designations;
 - whether any further classes of persons are approved to act as a cover pool monitor;
 - the form of the register; and
 - whether a fee should apply for the registration of covered bond programmes.
- 2 The Reserve Bank is consulting on these matters at this point in time so that the regime can operate effectively from the date of commencement into law, which is yet to be determined. This consultation document assumes there are no material changes to the Bill as enacted, to that reported back by the Select Committee.
- 3 A further matter which the Reserve Bank would like to solicit views on is the initiative of the European Covered Bond Council (ECBC) to provide a covered bond labelling regime.¹ Labels will be granted to issuers who self-certify that their covered bonds comply with the ECBC convention. The Reserve Bank is interested to know whether the ECBC's label convention has relevance to New Zealand banks.

Question 1: What are the implications of the ECBC labeling convention for New Zealand banks?

¹ <http://ecbc.hypo.org/Content/Default.asp>

SECTION 2: APPLICATION PROCESS AND INFORMATION REQUIREMENTS

- 4 Annexed to this consultation document is a draft Banking Supervision Handbook document that sets out the proposed application process and information requirements for applying to register a covered bond programme.
- 5 The Bill envisages that registered banks responsible for registered covered bond programmes must notify the Reserve Bank of a number of matters in relation to the covered bond programme. The proposed process for providing these notifications and information requirements are set out in the draft Handbook document.

Question 2: Do you have any comments on the application process and information requirements proposed in the draft Handbook document?

SECTION 3: ASSET CLASS DESIGNATIONS

- 6 The Bill envisages that the Reserve Bank will have the power to designate covered bond programmes to particular asset class categories based on the assets in, or that may be included in, the cover pool. Asset class designations could be used to signal the type and quality of a covered bond programme. A registered bank would indicate when applying to register a covered bond programme whether it intends to register under a particular asset class designation. A registered bank could also apply to have a designation allocated following registration of the programme. An asset class designation would not be compulsory. A registered bank which did not apply for an asset class designation would not be restricted as to the assets that it may include in its cover pool.
- 7 Should a registered bank's covered bond programme be registered under an asset class designation a number of requirements would apply in relation to that programme. These requirements include:
 - at the time of registration the bank has in place procedures and internal controls to ensure continual compliance of the cover pool with the asset class designation;
 - the bank must comply with those procedures and internal controls on an on-going basis;
 - the cover pool monitor's report must include an assessment of the bank's compliance with those procedures and internal controls;
 - the bank must notify the Reserve Bank if its programme is no longer consistent with the designation, or if the assets in the cover pool are not so consistent.

- 8 If the programme documentation or cover pool subsequently proves to be inconsistent with a given designation the designation will be removed.
- 9 The Reserve Bank does not consider that asset class designations are strictly necessary, given asset eligibility can be restricted by contract, but is interested in views on whether use of the power would provide a useful signalling device.
- 10 To this end, the draft Handbook document attached provides draft designations. Two categories have been articulated:
- Category A: Residential mortgage – at least 75% of the assets must be loans secured by residential property in New Zealand;
 - Category B: Property - at least 75% of the assets must be loans secured by property in New Zealand.
- 11 Whether the designation power will actually be exercised will be determined based on the feedback received on this consultation document.

Question 3: Do you consider that there are net benefits in the Reserve Bank designating asset classes for covered bond programmes?

Question 4: Do you have any comments on the categories articulated in the draft Handbook document?

SECTION 4: COVER POOL MONITOR

- 12 The Bill specifies that the cover pool monitor must be one or more of the following:
- a licensed auditor under the Auditor Regulation Act 2011;
 - a registered audit firm under the Auditor Regulation Act 2011;
 - a member of any other class of persons or firms that has been approved by the Reserve Bank.
- 13 Under the Auditor Regulation Act 2011, a natural person who is an overseas auditor may apply to be licensed and an overseas audit firm may be registered if a number of requirements are met.

- 14 The Reserve Bank considers that it is important that cover pool monitors be suitably qualified. However, it is also important to ensure that there is a sufficiently large pool of cover pool monitors to provide the services required on a competitive basis. The Reserve Bank considers that the ability of overseas auditors to apply to be licensed, or registered in the case of firms, will ensure that the pool of cover pool monitors is sufficiently large. Hence the Reserve Bank does not at this stage intend to approve other classes of persons as cover pool monitors.

Question 5: Do you agree that the pool of auditors licensed or registered under the Auditor Regulation Act 2011 is sufficiently deep to adequately provide the cover pool monitor requirements of the Bill?

SECTION 5: FORM OF THE REGISTER

- 15 The Bill requires that the Reserve Bank determine the form of the covered bond register and that the register be public. The Reserve Bank intends to publish the register on its website. The register will provide the following information:
- Name of registered bank;
 - Name of covered bond SPV;
 - Programme name;
 - Registration date;
 - International securities identification number for each series issued under the programme;
 - Currency of each series issued;
 - Value of each series issued, in both the currency of issue and NZD value at time of issue;
 - Date of each series issued;
 - Maturity date of each series issued;
 - Asset class designation.

Question 6: Do you consider that this information is appropriate for the public register?

SECTION 6: FEES

- 16 New section 139E(3)(b) of the Bill states that an application for registration of a covered bond programme must be accompanied by a fee (if any), as determined by the Reserve Bank and approved by the Minister by notice in the *Gazette*.
- 17 Having considered the Treasury's *Guidelines for Setting Charges in the Public Sector*, the Reserve Bank considers that it would be appropriate to charge a fee for the registration of covered bond programmes. The objective of the fee would be to reduce reliance on the Reserve Bank's general funding, and to allocate the costs of registration to those who receive private benefits.
- 18 The Reserve Bank considers that the registration of covered bond programmes provides private benefits to banks, in the form of reduced funding costs and risk. However, the Reserve Bank also considers that some portion of these benefits will accrue to the general public, through an improvement in financial stability, and also through reduced borrowing costs or higher deposit rates. For this reason, the Reserve Bank considers that a fee which recovered approximately 65% of the Reserve Bank's cost for registration would be appropriate.
- 19 The Reserve Bank estimates that it will take approximately a total of 4 days of analyst and management time to analyse and approve an application for registration. Assuming a charge out cost of \$250,000 per annum, this implies a cost of approximately \$3,850. The Reserve Bank therefore considers that it would be appropriate to charge a fee of \$2,500 for registration of a covered bond programme.

Question 7: Do you have any comments on the proposed fee?

Annex: Draft Handbook document

Registration of covered bond programmes

Process and information requirements

Prudential Supervision Department

Document BS16

Issued:

A: INTRODUCTION

- 1 The Reserve Bank of New Zealand Act 1989 ('the Act') sets out a number of requirements relating to covered bonds issued or guaranteed by New Zealand registered banks.
- 2 The Act requires that the Reserve Bank maintain a public register of the covered bond programmes of registered banks. Registered banks may not issue covered bonds except under a registered covered bond programme. The Act applies to covered bond programmes in existence prior to the commencement of the amendment Act, but provides transition arrangements in relation to those programmes.
- 3 The Act sets out the requirements for registration and the on-going requirements in relation to registered programmes. These are set out in Part B of this document. This document should not be seen as a substitute for legal advice.
- 4 The Act requires that the Reserve Bank specify the process for registration and the information required to be provided to the Reserve Bank. Part C of this document sets out this process, and Part D sets out the information requirements.
- 5 Section 139D(2)(b) of the Act provides that the Reserve Bank may designate registered covered bond programmes to a particular class of covered bond programme. Part E sets out the available designations.

B: REGISTRATION AND ON-GOING REQUIREMENTS

- 6 Section 139F of the Act provides that the Reserve Bank must not register a covered bond programme unless it is satisfied that a number of requirements are met. In summary, these are that:
- (a) The cover pool assets are, or will be, owned by an identified covered bond special purpose vehicle ('SPV') that is a company within section 2(1) of the Companies Act 1993;
 - (b) A cover pool monitor has been appointed under the covered bond programme. The cover pool monitor must be:
 - (i) independent of the registered bank; and
 - (ii) either a licensed auditor under the Auditor Regulation Act 2011 or a registered audit firm under that Act; and
 - (iii) required under its contract of appointment to provide reports consistent with the requirements of section 139I(1)(c) of the Act;
 - (c) A register of cover pool assets will be maintained;
 - (d) The programme documentation specifies procedures and internal controls that ensure:
 - (i) the up-to-date and accurate keeping of the register of cover pool assets; and
 - (ii) that the assets in the cover pool remain consistent with any asset class designation for which the registered bank may have applied;
 - (e) The programme documentation specifies a test, or tests, to determine whether the value of cover pool assets exceeds the principal amount outstanding on the covered bonds (referred to in this document as the 'asset coverage test');
 - (f) The programme documentation provides for the SPV to perform certain of the registered bank's on-going obligations if monies become due and payable by the SPV;
 - (g) The registered bank is in compliance with any requirements relating to covered bonds imposed by condition of registration.

- 7 The Reserve Bank may impose additional registration requirements by way of regulations. If the Reserve Bank were to do so, the registered bank would need to ensure it complied with these new requirements in respect of already registered programmes.
- 8 Section 139H of the Act imposes on-going requirements on the registered bank. The registered bank must:
- (a) Ensure that the asset coverage test is carried out annually and the Reserve Bank is notified of any test failure;
 - (b) Ensure that a register of cover pool assets is maintained and that, in doing so, the registered bank follows the internal controls and procedures noted in paragraph 6(d) above;
 - (c) Notify the Reserve Bank of:
 - (i) every issuance of covered bonds;
 - (ii) material changes to the registered covered bond programme;
 - (iii) failure of the programme, or cover pool, to comply with the asset class designation under which it is registered;
 - (d) Provide the Reserve Bank with any further information it requests in relation to the covered bond programme;
 - (e) Ensure that:
 - (i) it complies with the registration requirements;
 - (ii) the report of the cover pool monitor is provided to the bond and security trustees; and
 - (iii) the report of the cover pool monitor is provided to the Reserve Bank in specified instances.
- 9 The registered bank's on-going obligations terminate if any amount becomes due and payable by the covered bond SPV under the covered bond programme. If this occurs, the SPV must provide the Reserve Bank with any information it requests in relation to the covered bond programme.
- 10 In addition to the provisions of the Act relating to covered bonds, locally incorporated banks are subject to a condition of registration which limits the amount of assets encumbered in favour of covered bond holders.

C: PROCESS FOR REGISTRATION

- 11 A registered bank may apply to register a programme at any time. An application to register an existing programme should take account of the time the Reserve Bank may take to register the programme (see paragraph 14).
- 12 An application for registration should contain all the information in paragraphs 15-17 of Part D below. Applications should be addressed to:
- The Manager
Anti-money Laundering, Licensing and Investigations
Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498, Wellington 6140
- 13 The Reserve Bank may reject an application which does not provide all the necessary information. An application should be accompanied by a fee of \$2500.
- 14 The Reserve Bank may take up to 60 working days to consider an application for registration. Should the Reserve Bank intend to reject an application for registration, the Reserve Bank shall provide the applicant with a notice of that proposed decision, and the reasons for it, and shall give the applicant a further 10 working days to provide further information. The Reserve Bank will consider any further information submitted by the applicant in support of the application and give its final decision within a further 5 working days. A bank may request an extension to these timeframes.

D: INFORMATION REQUIREMENTS

Registration

- 15 The following information must be provided when making an application for registration:
- (a) The name of the registered bank applying for registration of a programme;
 - (b) The name of any other entity that may issue covered bonds under the programme, if different from the registered bank;
 - (c) The name and company number of the SPV holding the cover pool assets and the owners of that SPV;
 - (d) The name of the cover pool monitor and evidence that the person acting as cover pool monitor is either licensed as an auditor, or is a registered audit

firm and the person acting as cover pool monitor will be supervised by a licensed auditor;

- (e) Evidence that the cover pool monitor agreement meets the requirements of section 139I(1)(c) of the Act;
- (f) The names of the security and bond trustees;
- (g) Whether the registered bank wishes to register the covered bond programme under a particular asset class designation and, if so, evidence that the programme and the cover pool complies with that asset class designation;
- (h) Evidence that the covered bond programme specifies procedures and internal controls that ensure:
 - (i) an up-to-date and accurate register of cover pool assets will be maintained; and
 - (ii) that the cover pool assets will remain consistent with any asset class designation, if relevant;
- (i) The tests specified in the cover bond programme to determine, both before and after an event of default by the registered bank, that the value of cover pool assets exceeds the principal amount outstanding on the bonds;
- (j) Evidence that the SPV will perform the requirements of section 139H(1)(a) and (b)(i) in the event monies become due and payable by it;
- (k) The total value of cover pool assets in relation to that programme, in absolute terms and relative to the asset base of the registered bank;
- (l) The name and total allowable size of the programme under which the covered bonds are to be issued;
- (m) For existing covered bond programmes, the ISIN, currency, foreign currency value, NZD value at issue, issue date and maturity date for each issue already undertaken;
- (n) Name of person to whom questions should be directed.

16 The registered bank must provide a description of the structure of the covered bond programme and an outline of the contractual obligations of all parties involved in the arrangement. This may include a diagram representing the parties' obligations.

- 17 The Reserve Bank will consider a summary of the terms of contract relevant to paragraph 15 (e), (g), (h) and (j) as sufficient to meet the information requirements above.

On-going notification requirements

- 18 As set out in paragraphs 8(a) and 8(c), a registered bank is required to notify the Reserve Bank of certain matters in relation to registered covered bond programmes. Additionally, the Reserve Bank may request further information in relation to covered bond programmes. Notifications and information should be provided to:

The Manager
Anti-money Laundering, Licensing and Investigations
Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498, Wellington

- 19 Notification of the issuance of a series or tranche of covered bond (as required under section 139H(1)(c)(i)) should be provided to the Reserve Bank within 10 working days of the issue date of the series or tranche. The following information must be provided in relation to any covered bonds issued under a registered programme:

- (a) The international securities identification number (ISIN);
- (b) Value of issue in currency of issue and NZD at time of issue;
- (c) Currency;
- (d) Issue date;
- (e) Maturity date;
- (f) Total outstanding issuance of covered bonds in NZD, in absolute terms and relative to the asset base of the bank.

- 20 The registered bank must notify the Reserve Bank if the ISIN for the bond changes.
- 21 Section 105 of the Act (confidentiality of information) applies to information supplied to the Reserve Bank as a part of the registration process.

E: ASSET CLASS DESIGNATIONS

- 22 Under section 139D of the Act, the Reserve Bank may, based on the assets in, or that may be included in, the relevant cover pool, designate registered covered bond programmes to particular asset classes on the covered bond programme register.
- 23 It is not compulsory for a covered bond programme to have an asset class designation. However, a registered bank may apply to have its programme designated under a particular asset class. A registered bank should specify when making an application for registration of a programme whether it wishes the programme to be designated under a particular asset class designation. A registered bank may apply to have a programme designated to a particular asset class subsequent to the registration of the programme, or may apply to have the programme removed from the designation.
- 24 If a programme is registered under a particular asset class designation, the registered bank must comply with relevant provisions of the Act (see Part B). The registered bank is required to notify the Reserve Bank if the programme documentation, or cover pool, is no longer consistent with an asset class designation under which it is registered. In this case the designation will be removed.
- 25 The Reserve Bank has provided the following categories of asset class designation.

Category A: Residential mortgage

The following assets may be included in cover pools under this designation:

- (a) an at call deposit held with a New Zealand registered bank and convertible into cash within 2 business days;
- (b) a bank-accepted bill or certificate of deposit that:
 - (i) matures within 100 days; and
 - (ii) was not issued by the registered bank that issued or guarantees the covered bonds secured by the assets in the cover pool;
- (c) a bond, note, debenture or other instrument issued or guaranteed by the New Zealand Government or a foreign Government with a foreign currency credit rating of AA (or its equivalent) or above;
- (d) a loan secured by a first-ranking mortgage, charge or other security interest over residential property in New Zealand;

- (e) a mortgage insurance policy or other assets related to the loan referred to in (d);
- (f) a contractual right relating to the holding or management of another asset in the cover pool;
- (g) a derivative held for one or more of the following purposes:
 - (i) to protect the value of another asset in the cover pool;
 - (ii) to hedge risks in relation to another asset in the cover pool;
 - (iii) to hedge risks in relation to liabilities secured by the assets in the cover pool.

In order to qualify as a residential mortgage covered bond programme, the value of loans secured by a first ranking mortgage, charge, or other security interest over residential property in New Zealand must exceed 75% of the value of the cover pool assets securing the covered bond.

Category B: Property

The following assets may be included in cover pools under this designation:

- (a) an at call deposit held with a New Zealand registered bank and convertible into cash within 2 business days;
- (b) a bank-accepted bill or certificate of deposit that:
 - (i) matures within 100 days; and
 - (ii) was not issued by the registered bank that issued or guarantees the covered bonds secured by the assets in the cover pool;
- (c) a bond, note, debenture or other instrument issued or guaranteed by the New Zealand Government or a foreign Government with a foreign currency credit rating of AA (or its equivalent) or above;
- (d) a loan secured by a first-ranking mortgage, charge or other security interest over residential, commercial, development or agricultural property in New Zealand;
- (e) a mortgage insurance policy or other assets related to the loans referred to in (d);

- (f) a contractual right relating to the holding or management of another asset in the cover pool;
- (g) a derivative held for one or more of the following purposes:
 - (i) to protect the value of another asset in the cover pool;
 - (ii) to hedge risks in relation to another asset in the cover pool;
 - (iii) to hedge risks in relation to liabilities secured by the assets in the cover pool.

In order to qualify as a property covered bond programme, the value of loans secured by a mortgage, charge, or other security interest over commercial, residential, development or agricultural property in New Zealand must exceed 75% of the value of the cover pool assets securing the covered bond.