



New Zealand Market Subcommittee

Australian Securitisation Forum

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Re: ASF Securitisation Feedback on NZClear 2.0 factored securities functionality

Dear Mike

Firstly, thank you for continuing to engage with us to address the issues with amortising factored securities identified during the NZClear implementation. While the last four months have been trying, it is essential to remain focused on the future, and we thank you for that.

In April you sought suitable consensus from the industry on the features of amortising factored securities, to be used to develop a systems specification for your CSD vendor. We appreciate that it is essential to have clarity in respect of what the broader industry requires before investing in a solution to ensure that it is correctly scoped, addresses the issues at hand, and will be well supported.

In the attached document, we have sought to provide that suitable level of consensus on the key settlement and registry conventions, to assist RBNZ with reviewing and determining a development roadmap for NZClear 2.0.

We would also like to take this opportunity to outline the key outcomes and functions that the industry would like to see in the NZClear 2.0 roadmap.

The present situation in respect of amortising securities:

Amortising factored securities repay a varying allocation of principal to noteholders on a pro-rated basis at each payment date, leading to a non-linear reduction in outstanding principal value over the life of the security.

Presently the reduction in outstanding principal value is reflected in NZClear 2.0 by reducing the nominal value to the nearest integer, rounded up across all holders to the nearest whole number, previously, the reduction in face value was able to be processed to 2 decimal places. The loss of decimal places on the nominal value record has exacerbated what were existing issues for investors and custodians due to:

- Greater inconsistency between the holdings recorded in NZClear and, an investor's legal holding and the investor reporting they receive.
- The need for further manual intervention in the settlement and registry processes, including manual reconciliations and an inability to achieve straight-through-processing due to the need to adjust all principal payments manually.
- The inconsistencies in pay-downs between noteholders and the arising need for funds to be withheld from investors, are not contemplated in the legal documents, and lead to, along with the inconsistency treatment versus other markets, confusion and concern amongst investors, as noted by Bloomberg last year.

Functionality that the industry seeks:

Issuers, investors and custodians generally record the initial face value issued and apply a bond factor to calculate the current outstanding principal value, as such when a partial redemption of principal is paid:

- The security face value remains the same.
- The bond factor, usually eight decimal places, is adjusted down to reflect the reduced proportional principal outstanding.
- The outstanding principal value is calculated by multiplying the face value by the bond factor.

The use of bond factors allows a great deal of accuracy in calculating and reporting the outstanding principal.

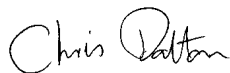
The functionality that we ask that RBNZ consider implementing in NZClear 2.0 to support market participants include:

- Making factored securities easily identifiable.
- The ability for the registrar to record the current bond factor, being the outstanding principal amount after the settlement of the current payment date expressed as a decimal multiplier of the nominal value, against each factored security.
- The ability for NZClear users to access past and current bond factors within security reference data.
- The ability to process partial redemptions of factored securities with no reduction in the nominal (face) value of the noteholders holding.
- The ability for NZClear to calculate the correct principal amount to be paid for a partial redemption based on past and current bond factors.
- The ability for NZClear to calculate the correct coupon to be paid based on the appropriate reference rate, margin and outstanding principal value through the payment period.

- The ability to settle the capital and interest component of the partial redemption as separate payments for ease of reconciliation for noteholders.
- Trade processing and other functions will also need to be reviewed to support factored security settlement; identifying the correct principal element based on the current bond factor rate, for example.

While we have outlined key functionality, this is a complex process, and we are available to discuss the functionality that the industry seeks and to work with your team as required to provide any further clarification. We also feel that, when appropriate, it would be helpful for ASF to be included in reviewing your vendor's proposed development recommendations and providing industry feedback.

Yours sincerely,



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