Australian Securitisation Forum
New Zealand Market

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Finance and Expenditure Committee
Parliament Buildings
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Inquiry into banking competition – ASF New Zealand Market Subcommittee Submission

The New Zealand Market Subcommittee of the Australian Securitisation Forum (ASF) appreciates the opportunity to respond to the Finance and Expenditure Committee's Inquiry into banking competition (inquiry). This submission primarily comments on the competition barriers for non-bank lending institutions who rely on securitisation as their primary source of funding to enable them to provide loan products to consumers.

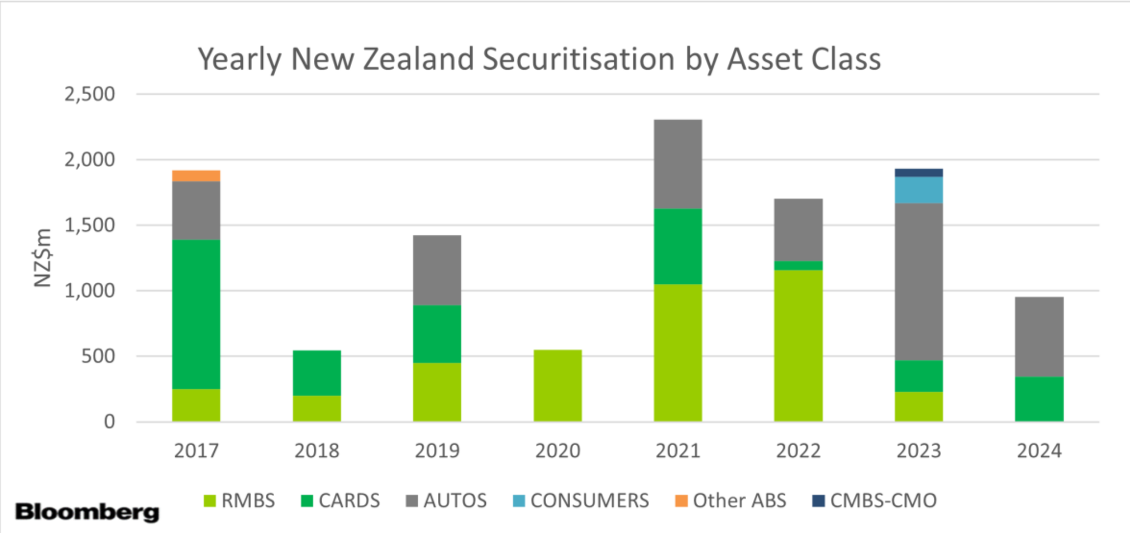
The ASF was formed in 1989 and is the peak industry association representing participants in the Australian and New Zealand securitisation markets. The ASF's role is to promote the development of securitisation and covered bonds in Australia and in New Zealand by facilitating the formation of industry positions on policy and market matters, representing the industry to local and global policymakers and regulators and advancing the professional standards of the industry through education and market outreach opportunities. Further information on the ASF and its activities can be found at www.securitisation.com.au

A. Securitisation markets

Securitisation markets are a key funding channel for an economy, increasing the availability and reducing the cost of funding for households and companies by opening investment opportunities to a wider investor base, diversifying risk across these economies and offering a reliable source of funding for banks and non-bank lending institutions (NBLIs). Securitisation has traditionally contributed to funding real economy assets such as residential mortgages, auto loans and small-to-medium enterprise (SME) lending and other assets. Furthermore, securitisation provides a medium through which New Zealanders' savings (KiwiSaver, managed funds) can be invested to further the aspirations of fellow New Zealanders and the growth of the New Zealand economy in funding home loans, car loans and business loans, including the funding of productive equipment.

B. <u>New Zealand securitisation market background</u>

Since 2017, the New Zealand securitisation market has seen total public capital market issuance of c.NZD11bn, split reasonably evenly between residential mortgage-backed securities (RMBS) and consumer auto, credit card and commercial mortgage asset backed securities (ABS). Although the securitisation market has not seen significant growth in New Zealand, it has diversified in terms of innovation and product offering to consumers with the ABS market now including autos, equipment, personal loans and SME lending activities.



The market has seen solid growth by current providers. However, the current regulatory settings provide a disincentive for current providers to remain and create barriers to entry for potential future providers. 2024 alone has seen two NBLIs, Resimac and Bluestone, announce their exit from the New Zealand home loan market and consequently the securitisation market, citing restrictions in the competitive environment for NBLIs.

ASF perspective

The New Zealand securitisation market provides a competitive dynamic in New Zealand's concentrated banking market to exert downward pressure on margins for mortgages and other consumer finance than otherwise would prevail in the absence of the public securitisation market. However, challenges in the securitisation market provide a disincentive for both current and potential future providers. This in turn reduces competition and choice for consumers.

C. Regulation of the securitisation market

A supportive regulatory framework will create a well–functioning, transparent securitisation market enabling the development of a diverse and competitive financial landscape. Regulation should be targeted to the circumstances of securitisation arrangements. In particular, it should manage the interconnection between:

1. the wholesale securitisation market consisting of local and international fund managers and other wholesale investors (such investors are sophisticated and well-resourced); and
2. prudentially regulated deposit taking institutions (DTIs),

through capital adequacy measures calibrated for DTIs' exposure to the sector. For example, in the provision of private warehouse financing facilities.

As background, before residential mortgage and asset-backed securities are issued into the debt capital markets, banks typically provide '*warehouse facilities*' to NBLIs. These are similar to revolving credit facilities with the same structural features as public market issued securities. Loan assets are incubated as they reach the scale required to support a debt capital markets issue.

Warehouse facilities are not currently specifically regulated. The warehouse banks apply capital charges against these facilities as they would against any other corporate lending facilities. The current bank capital regulations permit favourable capital treatment for warehouse facilities if they achieve a minimum rating from an external credit rating agency. However, for operational and cost considerations, many of these warehouse facilities do not seek an external credit rating. Banks therefore must apply a punitive capital weight against this lending, despite the enhanced structural features which, if rated, would achieve a high rating, typically AAA or AA as most banks have internal rating methodologies that are commensurate to those used by external rating agencies. This raises the cost of capital for NBLIs which ultimately flows into the interest rates they charge consumers. We believe it would be a simple exercise to formulate a specific standard for DTI exposure to securitisation structures, including unrated securitisation warehouses. This process is not without precedent, with the Reserve Bank of New Zealand (RBNZ) currently proposing a specific risk weight of the New Zealand Superannuation Fund[1]. This concept could be extended to complying securitisation exposures that meet an agreed standard.

The lack of a specific securitisation banking standard also means that when the RBNZ, as the prudential regulator, imposes regulations on the banking sector (such as debt to income limits) the warehouse providers 'look-through' their warehouse facilities, effectively applying the regulation on NBLIs. This occurs whether or not the RBNZ intended to apply such prudential

[1] Deposit Takers Core Standards, Policy proposals consultation paper dated 16 May 2024

regulations upon NBLIs. The proportionality concept means that there may be instances where the RBNZ wishes to apply differing standards on banks and NBLIs.

We believe that the introduction of a banking standard for securitisation would provide a source of legitimacy to the NBLI industry, empowering current and potential future participants, improving investor confidence and helping to facilitate scale.

ASF perspective

The current prudential framework applicable to securitised exposures does not give direct priority to competition in consumer lending. Should the Government wish to give greater balance in relation to prudential regulatory settings to prioritise competition in lending it could reconsider if the regulatory costs of capital applicable for securitised exposures are appropriate and formulate a specific standard for securitisation exposures.

D. Residential Mortgage Standard Bond

The RBNZ's RMO[2] standard residential mortgage bond was an attempt to introduce to the New Zealand market a tradeable format that would satisfy repo-eligibility requirements and more importantly create a more liquid market for funding residential mortgages. The RMO was a securitisation instrument with certain standardised terms and structural features. The RMO was put on hold during the COVID pandemic period and ultimately abandoned.

If the Government is focussed on competition in home loan lending, there must be a broader choice of lenders and home loan products for consumers. However, to facilitate this outcome, the NBLIs that provide such consumer choices must be able to grow and without a liquid securitisation market this continues to present a real challenge. Whether it is an RMO or an enhanced repo structure for public RMBS and ABS the securitisation market must be able to grow to facilitate the level of funding required for there to be greater competition in the home loan market and across other consumer finance.

E. Liquidity back stop facility for market disruptions

The ASF believes that it would be beneficial for the Government to establish a liquidity back stop facility. The facility could be easily activated in the event that there is a significant disruption in the global financial markets, or where the Government wishes to intervene to temporarily address competitive or structural distortions in sections of the financial markets, such as the home loan market. This would help ensure that NBLIs and smaller banks, who rely on securitisation to fund their loans, would still be able to originate new loans and compete where

[2] RMO – residential mortgage obligation (STC mortgage bond collateral standard).

necessary with financiers such as DTIs who do not rely on securitisation. Australia successfully implemented such a program during the COVID period in 2020.

F. Conclusion

1. NBLIs require their warehouse funding partners to offer terms that enable the NBLIs to provide more cost effective and innovative products to their customers. The NBLIs play a key role in ensuring there is competitive pressure in the New Zealand market which gives consumers more options and results in better customer outcomes.

2. The risk profile of the underlying assets funded through bank warehouse facilities, when overlaid with the structural protections in place, should be similar to the products that the banks themselves provide (i.e. mortgages, consumer loans etc).

3. Therefore, a standard that looks through to the underlying assets in the warehouses would result in a more appropriate RWA treatment for these exposures. This will promote a more equitable internal capital allocation across different lending categories, rather than making banks focus on assets that have a favourable capital treatment.

ASF perspective

If the Government values competition in the home loan market and wishes to promote the growth of other consumer finance sectors such as SME lending, along with promoting the debit capital markets, it must have a supportive policy position towards the role and benefits of securitisation in funding economic growth in New Zealand.

The ASF would welcome the opportunity to appear before the Finance and Expenditure Committee to elaborate on matters outlined in this submission and indeed any other matter relating to NBLIs (and new entrants) gaining access to the wholesale securitisation market to fund home loans and consumer financing.

Yours sincerely,

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