ANZ Bank New Zealand Limited/ANZ New Zealand (Int'l) Limited

Mortgage Covered Bonds

Full Rating Report

Ratings/Outlook

Mortgage covered bonds	AAA/Stable

Rating Rationale

Bank IDR/Outlook	AA-/Stable
IDR uplift	0 notches
PCU	6 notches
Tested rating on PD basis	AA+
Recovery uplift	1 notch
Covered bond rating	AAA/Stable
AP Fitch considers in analysis (%)	39.7
'AAA' breakeven AP (%)	90.0

Key Data

	30 Apr 19
Asset type	Residential mortgages
Bond maturity profile	Soft bullet
Cover assets (NZDbn)	11.1
Covered bonds (NZDbn)	4.0
Nominal OC (%)	180.6
WA life of assets (years)	11.8
WA life of liabilities (years)	4.0

Payment Continuity Uplift Reduction

Asset segregation	No
Alternative manager	No

Rating Constraint

None

Source: Fitch Ratings

Related Research

ANZ Bank New Zealand Limited (April 2019)

ANZ Bank New Zealand Limited – Ratings Navigator (April 2019)

APAC Covered Bonds Quarterly - 1Q19 (May 2019)

Covered Bonds Surveillance Snapshot (May 2019)

'B' Portfolio Loss Rates for Covered Bonds (September 2018)

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Key Rating Drivers

Four-Notch Downgrade Buffer: The 'AAA' covered bond rating is based on ANZ Bank New Zealand Limited's (ANZNZ) Long-Term Issuer Default Rating (IDR) of 'AA-', an IDR uplift of zero notches, a payment continuity uplift (PCU) of six notches, a recovery uplift of one notch and the asset percentage (AP) of 39.7% that Fitch Ratings takes into consideration in its analysis, which is significantly lower than our 'AAA' breakeven AP of 90.0%. The four-notch buffer against a downgrade of the bank's IDR supports a Stable Outlook on the rating.

Zero IDR Uplift: The New Zealand open bank resolution (OBR) framework does not explicitly exempt covered bonds from being bailed in. Therefore, a zero IDR uplift is assigned to New Zealand programmes as there is no preferential treatment of covered bonds compared with the bank's other senior debt under the OBR.

Soft-Bullet Bonds Back Uplift: Fitch's PCU of six notches reflects the liquidity protection via a 12-month extension period on the soft-bullet bonds. It also reflects interest-protection provisions in the form of a reserve covering interest payments and senior expenses on a rolling three-month basis should ANZNZ lose its Short-Term IDR of 'F1+'.

Currency Risk Caps Recovery: The recovery uplift is capped at one notch, as Fitch believes foreign-exchange risk could affect recoveries should the bonds default. Liability swaps are in place to cover currency risk, but Fitch believes the swaps would terminate upon a covered bond default. This means longer-dated New Zealand dollar asset cash flow would provide recoveries in a different currency than the bonds.

ALM Loss Drives AP: The 'AAA' breakeven AP of 90.0% equates to a breakeven overcollateralisation (OC) of 11.1% and is equivalent to the programme's maximum contractual AP. The breakeven OC is driven by the ALM loss component of 5.8%, reflecting modelled asset and liability mismatches, inclusive of the effect of the pro rata sales clause documented in the programme. The credit loss component of 4.1% reflects the credit quality of the underlying cover pool and is in line with that of local peers.

Programme Highlights

Stable Credit Risk: The cover pool comprised 56,949 loans at end-April 2019, with a total balance of NZD11.1 billion. The weighted-average (WA) loan/value ratio (LVR) was 55.1% and WA seasoning of the pool was 40 months. Interest-only loans formed 12.1% of the cover pool. Fitch calculated that, in a 'AAA' scenario, there would be a cumulative WA foreclosure frequency of 13.7% and a WA recovery rate of 64.5% for the cover pool.

Model Outputs Grandfathered: Fitch relied on its previous asset and cash flow model outputs as the programme characteristics (cover pool and OC) have remained stable and the programme satisfies all the conditions set out in the Covered Bonds Rating Criteria relating to previous model-analysis application.

Flexi Loans Increase Risk: Loans linked to a flexible loan product, an at-call secured credit line, make up around a quarter of the cover pool. Flexi loans are excluded from the pool, but their repayment is subordinated to the attached mortgages in the cover pool. The probability of default (PD) of linked cover assets is increased due to the at-call nature of flexi loans, which may attract a lower sale price than non-linked assets, leading Fitch to adjust the market value.

Selected Peers for Comparison

Issuer/ programme	IDR/ Outlook	Covered bond rating
ASB Bank Limited	AA-/ Negative	AAA/ Stable
Bank of New Zealand	AA-/ Negative	AAA/ Stable
Kiwibank Limited	AA-/ Stable	AAA/ Stable
Westpac New Zealand Limited	AA-/ Stable	AAA/ Stable

Source: Fitch Ratings

Peer Comparison

The table below compares the key rating drivers for ANZNZ with those of four other regulated covered bonds issued by New Zealand banks rated in the 'AA' category. The selected peers are listed in the table in the left margin.

The 'AAA' breakeven AP for ANZNZ's covered bond programme is 90.0%, which corresponds to a higher than peer-average breakeven OC of 11.1%. Similarly to peers, ANZNZ's ALM loss is the main driver of the 'AAA' breakeven OC, which represents the non-credit loss components of the breakeven OC for the rating. Barring one of the peers, this component is higher than the other three peers' ALM loss because of higher refinancing stresses applied due to specific non-standard characteristics affecting the modelled sale price on the covered bond assets.

The credit quality of the underlying cover pool, as reflected by the credit loss component of 4.1%, is in line with the peer average. Please see the *Covered Bonds Surveillance Snapshot* and related *excel file* for a detailed comparison of rating drivers across Fitch-rated covered bond programmes.

Peer Comparison: Key Rating Drivers

	ANZNZ	Selected peer average	Selected peer range
IDR/Outlook	AA-/Stable	AA-/Stable	AA-/Negative – AA/Stable
IDR uplift	0	0	0
PCU	6	6	6
'B' portfolio loss rate (%)	0.2	0.5	0.2-0.7
'AAA' breakeven OC (%)	11.1	10.8	8.7-12.4
Breakeven OC components (%)			
Credit loss (%)	4.1	3.6	3.5-3.7
ALM loss (%)	5.8	6.1	5.0-8.7

Data as of end-May 2019
Source: Fitch Ratings

Country Risk

The programme is not affected by country risk because its 'AAA' rating is in line with New Zealand's Country Ceiling and is the maximum rating achievable. Please see *Structured Finance and Covered Bonds Country Risk Rating Criteria*.

Sensitivity Analysis

The covered bonds will be vulnerable to a downgrade if ANZNZ's Long-Term IDR falls below 'BBB+', or if the total number of notches represented by the IDR uplift, PCU and recovery uplift falls to two or less. If the AP we rely upon rises to the maximum 90.0% contractual AP stipulated in the programme documents, there will be no impact on the rating of the covered bonds.

The Fitch breakeven AP for the covered bond rating will be affected, among other factors, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuance. Therefore, the breakeven AP to maintain the covered bond rating cannot be assumed to remain stable over time.

Related Criteria

Covered Bonds Rating Criteria (June 2019)

Bank Rating Criteria (October 2018)

Structured Finance and Covered Bonds Counterparty Rating Criteria (April 2019)

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (April 2019)

APAC Residential Mortgage Rating Criteria (June 2019)

Structured Finance and Covered Bonds Country Risk Rating Criteria (October 2018)

Abbreviations

AP: asset percentage

PCU: payment continuity uplift

IDR: Issuer Default Rating

OC: overcollateralisation

PD: probability of default

WAFF: weighted-average frequency of foreclosure

WARR: weighted-average recovery rate

The Issuer

ANZNZ is New Zealand's largest full-service bank and one of the nation's oldest. It commenced operations in 1840 when its parent bank opened its first branch in the country. ANZNZ provides a full range of banking options, including personal, rural, corporate, commercial, institutional and private banking. The bank has the country's largest domestic branch network and serves more than two million customers. ANZNZ had assets of NZD165 billion and a domestic market share of approximately 30% of total registered banking assets as at end-March 2019. The bank is a wholly owned subsidiary of Australia and New Zealand Banking Group Limited (AA-/Stable/F1+). The outstanding covered bonds have been issued through ANZ New Zealand (Int'l) Limited (ANZNIL), a guaranteed issuing vehicle used for international funding by ANZNZ.

Fitch's most recent reports on ANZNZ's bank ratings are a *Full Rating Report* and *Ratings Navigator*.

IDR Uplift: Zero Notches

An IDR uplift of zero notches applies for all Fitch-rated New Zealand covered bond programmes. The country's OBR allows for the bail-in of creditors, but does not explicitly exempt covered bonds from bail-in. Fitch believes there is a risk of a switch of recourse to the cover pool from the issuer upon resolution of the bank, as secured assets are exempt from the OBR process. Therefore, ANZNZ's Long-Term IDR remains the floor of its covered bond rating as there is no preferential treatment of covered bonds compared with the bank's other senior debt under the OBR.

PCU: Six Notches

The PCU of six notches reflects the strength of the liquidity protection in place. This is based on the 12-month extension period on the soft-bullet bonds and three-month interest protection in the form of a reserve to be funded upon the loss of ANZNZ's Short-Term IDR of 'F1+'.

None of the other factors influencing payment continuity analysed by Fitch (see *Appendix 3*) represent high risk, which would otherwise be reflected in a PCU reduction.

Recovery Uplift: One Notch

The recovery uplift on the rating is capped at one notch, as Fitch believes foreign-exchange risk could affect recoveries in light of a default of the covered bonds. This is because the cover assets are denominated in New Zealand dollars, while the covered bonds are euro-denominated. Fitch believes the covered bond swaps on the liabilities will be terminated in a default scenario, so the longer-dated asset cash flow would provide recoveries in a different currency than the covered bonds. The agency believes this could lower recovery expectations.

Cover Pool

Cover pool data were available on a loan-by-loan basis as of end-April 2019.

ANZNZ Cover Pool

Characteristics as of end-April 2019

General		**Geographical breakdown (%)**	
Current principal balance (NZDbn)	11.1	Auckland	52.6
Number of loans	56,949	Wellington	11.1
Average loan balance (NZD)	316,774	Canterbury	10.5
Maximum loan group balance (NZD)	2,000,000	Waikato	8.2
WA seasoning (months)	40.0	Bay of Plenty	4.3
WA interest rate (%)	4.5	Otago	3.8
WA remaining term to maturity (months)	237.6	Manawatu-Wanganui	2.7
WA current LVR (%)	55.1	Hawkes Bay	1.8
Interest-only loans (%)	12.1	Nelson/Marlborough	1.6
Investment property (%)	21.1	Northland	1.6
		Taranaki	1.0
Substitute assets		Gisborne	0.5
Cash in GIC account (NZD)	0	West Coast	0.3
		Southland	0.1
Loan type (%)			
Fixed	91.1	**Loan arrears (%)**	
Variable	8.9	>30 days and <= 60 days	0.1
		>60 days and <=90 days	0.1
Property type (%)		>90 days	0.0
House	90.2		
Unit	9.8		

Source: Fitch Ratings, ANZNZ

Default Model Output (%)

Rating level	WAFF	WARR	WA MVD	Loss rate
AAA	13.7	64.5	62.1	4.8
AA+	12.5	68.7	58.8	3.9
AA	11.3	72.9	55.6	3.1

MVD: Market Value Decline
Loss rate = WAFF * (1-WARR)
Source: Fitch Ratings

Cover Pool Credit Analysis

Fitch analysed the collateral portfolio using its applicable mortgage loss criteria for New Zealand in its *APAC Residential Mortgage Rating Criteria*. ANZNZ's origination, servicing practices and staff qualifications are in line with those of other New Zealand prime lenders. The composition and credit quality of the cover pool may change over time because of the dynamic nature of the programme.

The cover pool's credit-risk profile has been relatively stable over the previous 12 months. The cover pool comprised 56,949 loans, with an aggregate outstanding amount of NZD11.1 billion as of end-April 2019. All loans are secured by a first-ranking mortgage. The WA current LVR was 55.1% and WA seasoning of the mortgage loans was 40 months. Interest-only loans by balance formed 12.1% of the pool. The cover pool was geographically diversified across New Zealand, with the largest concentration in Auckland by balance (52.6%), followed by Wellington (11.1%). See the *ANZNZ Cover Pool* table above.

Currently, around a quarter of the cover pool is linked to a flexible loan product – an at-call secured credit line – attached to the same secured property as the cover assets. The flexi-loans themselves are excluded from the cover pool, but their repayment is subordinated to the attached cover pool mortgages. The PD of linked cover assets is increased by 200% due to the flexi-loans' at-call nature, unless the cover asset is a bullet loan, where the PD is already increased by 300%.

ANZNZ has provided Fitch with a comprehensive set of loan-by-loan data, which includes the majority of data fields used in the agency's analysis of New Zealand residential mortgages. Fitch did not receive any information on first-home buyers as part of this data set. As a result, the agency assumed that a proportion of borrowers were first-home buyers when applying for their mortgages and adjusted default probabilities accordingly. The agency adjusted the PD by a further 5%, as the programme allows borrowers further advances on mortgages included in the cover pool, which can alter the credit profile of the pool over time.

The two key components of the PD on residential loans are the willingness and ability of a borrower to make payments on the loan, according to Fitch's methodology. Willingness to pay is usually measured by the current LVR: increased PD is assigned to high-LVR loans. The ability to pay is measured by the ratio of the borrower's income to the mortgage payments: the debt/income ratio. ANZNZ does not supply Fitch with income information to assess ability to repay. Therefore, Fitch has increased the PD by 20%. Fitch further adjusts the PD to account for borrower- and asset-specific characteristics. Recovery rates are driven by market value decline assumptions.

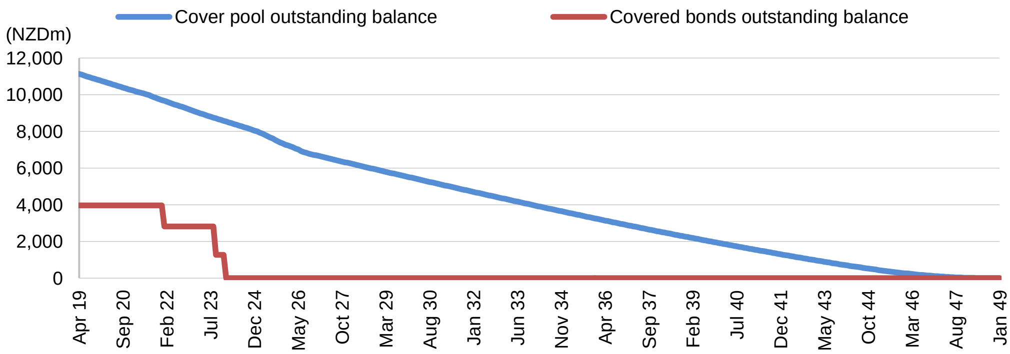
Fitch derived stressed cumulative default and recovery rates for the cover pool based on the loan-by-loan analysis of the cover assets and by taking into account the features of the mortgages. Fitch relied on its previous asset model outputs, as the programme characteristics have remained stable and the programme satisfied all the conditions set out in the Covered Bonds Rating Criteria. At last analysis, the WA frequency of foreclosure equated to 13.7% and the WA recovery rate to 64.5% in a 'AAA' rating scenario, which is equivalent to an expected loss rate of 4.8% (see *Default Model Output* table).

Cash Flow Analysis

Fitch's cash flow model simulates asset cash flow to reflect prepayments, servicing costs, delinquencies, defaults and recoveries in multiple stress scenarios under various issuer default timings. The model tests whether the cover pool can service principal and interest payments on the covered bonds in a timely manner, while hypothesising a switch to the cover pool as a source of payment at different dates. Based on Fitch's analysis, an AP of 90.0% is sufficient to withstand the agency's 'AA+' tested rating on a PD basis in the covered bond cash flow model.

The graph below shows the amortisation profile of the assets, assuming no prepayments and the amortisation of the outstanding covered bonds.

Amortisation Schedule



Source: Fitch Ratings, ANZNZ

Maturity Mismatches

The cover assets are amortising, with a WA remaining maturity of 11.8 years, while the covered bonds have a WA residual maturity of 4.0 years. As a result, temporary liquidity surpluses or shortfalls that may arise could strain available resources. Fitch models any cash not needed to repay liabilities as being reinvested with a new deposit account provider at an assumed rate of 50bp below the one-month bank bill reference rate (BKBM).

The agency assumes that if there is a liquidity shortfall, an alternative manager would be able to sell part of the mortgage portfolio within the timeframe provided by the maturity extension on the soft-bullet covered bonds. The ability to find a buyer will depend on a number of factors, including buyer appetite in light of the economic environment and the proportion of the portfolio required to be liquidated.

Under the documents, the amount of assets that can be sold for any one bond is contractually restricted to a pro rata proportion of that bond against the total covered bond liabilities outstanding. This restriction ensures earlier-maturing covered bonds cannot use additional cover pool assets over and above their pro rata allocation to the detriment of later-maturing bonds (see *Appendix 1: Analysis of the Programme's Structural and Legal Aspects*). Fitch has replicated this feature in its cash flow modelling of this programme.

Fitch assumed a refinancing cost for any potential buyer to determine the stressed price at which such asset sales would occur, as shown in the table below. However, in light of the lack of a precedent in New Zealand, there is no guarantee that a portfolio can be realised in any prevailing economic environment.

Refinancing Spread Levels

(bp)	AAA	AA	A	BBB	BB	B
New Zealand mortgage loans	250	218	189	165	144	125

Source: Fitch Ratings

Fitch has adjusted its refinancing spread assumptions used for New Zealand, simulating refinancing stress from the sale of the standard mortgage cover assets to meet covered bond repayments. This is to incorporate the additional refinance risk of linked flexi loans to the cover assets. The flexi loans would also need to be sold in the event of the cover assets being sold, leading to higher refinancing costs for the programme. Flexi loan products are not standard across New Zealand and could be more difficult to sell to a third-party. This would also increase the amount of loans needed to be sold, potentially affecting the sale price of the cover assets.

Fitch considered an additional stressed refinancing rate differential of 100bp above New Zealand's base mortgage refinance stresses for cover assets linked to at-call line-of-credit loans. The agency applied the adjusted refinancing stress on the pro rata value of the linked cover assets. The revised mortgage refinance stress on the 'AA+' tested rating on a PD basis was 334bp. ANZNZ's refinance spread at 'AA+' was adjusted to 262bp from the base rate of 234bp, based on the pro rata value of the linked flexi loans to the cover pools.

Hedging

The covered bond guarantor (CBG) has entered into a total return swap agreement with ANZNZ to swap the interest paid on the loans into BKBM plus a margin each month. The CBG has also entered into a covered bond swap with ANZNZ for each series of covered bonds to hedge currency-exchange risk between the New Zealand dollar flows received from the total return swap and the amount due on the euro-denominated covered bonds. No foreign-exchange stresses are applied, as the programme is fully hedged. The covered bond swaps in place are forward-starting swaps; this means there will be no exchange of cash flows under the covered bond swaps as long as ANZNZ acts as swap counterparty and no issuer event of default has occurred.

Hedging Summary

Swap type	Currency	(%)	Swap provider	Rating
Total return swap (assets)	No	100	ANZNZ	AA-/Stable/F1+
Fixed/floating (liability)	Yes	100	ANZNZ	AA-/Stable/F1+

Source: Fitch Ratings, ANZNZ

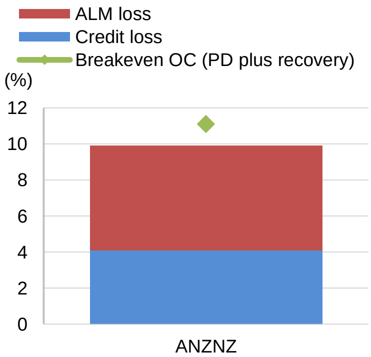
The cover assets, which are a mix of fixed- and variable-rate mortgages, are hedged with a total return swap (TRS) provided by ANZNZ. Fitch assumes the fixed-rate portion of the cover pool could be swapped should there be a need to replace the TRS. Therefore, the agency models the lower of the fixed-floating swap margin and 2%, which is the maximum swap margin given credit for in the modelling of the programme. For the variable-rate products, we assume a stressed asset margin of 2%, as the agency does not expect the TRS to be replaced for these products.

Fitch models all liabilities with floating rates in New Zealand dollars, as this is their post-swap status. All swap documentation entered into mitigates counterparty risk, which is in line with Fitch's criteria. This includes the swap counterparty having to post collateral for its obligations if it is downgraded below certain rating levels or a replacement of the swap counterparty/guarantee on its obligations.

Breakeven AP for the Rating

Fitch relied on its previous cash flow model outputs, as the programme characteristics have remained stable and the programme satisfied all the conditions set out in the Covered Bonds Rating Criteria. At last analysis, Fitch calculated a 'AAA' breakeven AP of 90.0%, which equates to an OC of 11.1% and is equivalent to the programme's maximum contractual AP. The 'AAA' breakeven AP relates to a 'AA+' tested rating on a PD basis and one-notch recovery uplift to the 'AAA' covered bond rating. The breakeven AP is dependent on multiple factors that could be affected by significant movements in the WA interest rate on the bonds or a change to the WA remaining term. Fitch will regularly reassess the breakeven AP in line with the covered bond ratings and upon new issuances or changes in the cover pool.

Breakeven OC Components



Source: Fitch Ratings

The equivalent 'AAA' breakeven OC of 11.1% is driven by an ALM loss component of 5.8%, which represents the non-credit loss components of the breakeven OC. This corresponds to the sum of the cash flow valuation and asset disposal loss, the two components replaced by Fitch's ALM loss under the agency's *Covered Bonds Rating Criteria* published in August 2018. The ALM loss component reflects the modelled asset and liability mismatches as well as the refinance costs and the effect of the pro rata sales clause in the programme. At last analysis, the stressed WA residual life of the cover assets calculated by Fitch was 6.2 years (including prepayments) and liabilities (including the extension period) was 2.2 years. The credit loss reflects the cover pool's credit quality and contributes 4.1% to the breakeven OC for the rating.

The breakeven AP for the rating will be affected, among other things, by the cover pool's credit quality and the profile of the cover assets relative to the outstanding covered bonds. These factors can change over time.

AP Fitch Relies On

The agency takes the AP of 39.7%, the highest nominal AP calculated in the last 12 months, into account in its analysis, because the OC in excess of that calculated in the asset coverage test (ACT) is secured by a demand loan back to the issuer that ranks junior in repayment to covered bondholders. Therefore, covered bondholders can rely on those assets for repayment of the covered bonds.

Programme Review

Fitch will review periodically the credit quality of the cover pool and perform a cash flow analysis to assess whether the AP taken into account by the agency provides protection against identified risks commensurate with the rating of the covered bonds issued by ANZNZ under this programme. Cover pool and covered bond information is updated quarterly and displayed on Fitch's covered-bond surveillance tool (available at *www.fitchratings.com*) and in the quarterly Covered Bonds Surveillance Snapshot.

Disclaimer

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Appendix 1: Analysis of the Programme's Structural and Legal Aspects

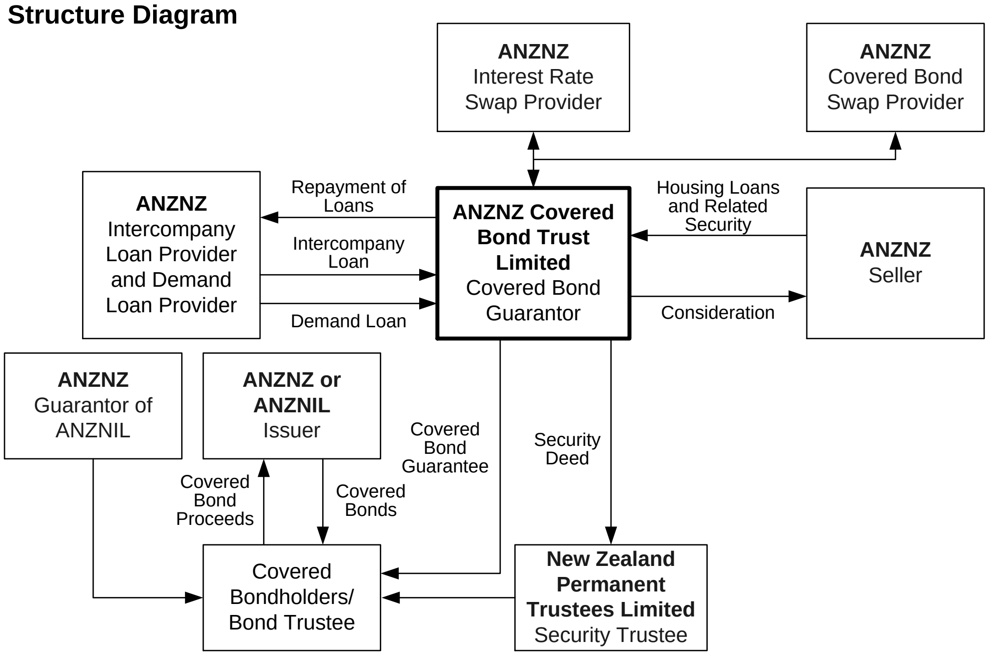
Programme Overview and Basis for Dual Recourse

ANZNZ and ANZNIL can issue hard- and soft-bullet covered bonds up to EUR8 billion under this programme. ANZNIL's bonds are guaranteed by ANZNZ, as long as ANZNZ remains solvent. The bonds are also guaranteed by the ANZNZ Covered Bond Trust Limited – the CBG – and secured by a dynamic pool of New Zealand residential mortgages.

The programme obtained registered status with the Reserve Bank of New Zealand (RBNZ), as required under the RBNZ (Covered Bonds) Amendment Act 2013, on 8 August 2014.

As long as ANZNZ is solvent, the bank and ANZNIL will pay covered bond obligations when due pari passu among themselves and with their senior liabilities, irrespective of cover asset performance, as they are direct, unconditional, unsecured and unsubordinated obligations of the issuers. On a second recourse, should there be an event of issuer default and the issuer receive notices to pay from the bond trustee, the covered bondholders also benefit from a recourse against the CBG that is secured over the cover assets. Upon the trigger of the second recourse, the cover pool becomes the source of payments. The asset and cash flow stresses applied by Fitch to the cover pool and covered bonds are described in the report's main body.

Structure Diagram



Source: Fitch Ratings, ANZNZ

Structural Features of the Programme

ANZ Bank New Zealand Limited Mortgage Covered Bonds

Structural feature	Explanation
ACT	The ACT is designed to ensure a minimum level of OC on the covered bonds to protect bondholders against specific credit and market risks. It is calculated monthly, prior to the service of a notice to pay on the CBG, so long as bonds are outstanding under the programme. If breached, failure to satisfy the ACT on or before the immediately succeeding monthly calculation date after the breach will constitute an issuer event of default. The ratio between covered bonds and cover assets may not exceed 90% (the contractual maximum AP) at any time.
Amortisation test	After a service of a notice to pay on the CBG, an amortisation test verifies whether the value of the cover pool, including any cash held in the GIC account and any substitute assets, adjusted to account for delinquencies and collateral value, is higher than the notional amount of the outstanding covered bonds. Failure to pass the amortisation test will trigger a CBG event of default, which allows the bond trustee to serve a guarantor acceleration notice. The CBG will be obliged to sell the loans and the proceeds will be used to repay, pro rata, the outstanding covered bonds. The amortisation test mitigates time subordination of covered bonds within the programme.
Demand loan	In this programme the demand loan funds all voluntary OC in the programme, purchase price of further advances or reimbursement for cash redraws, any interest rate shortfall, any ACT and pre-maturity test breach. At a demand loan repayment date a prepayment can occur in accordance with the priority of payments for as long as the ACT will not be breached as a result of the repayment. The repayment of the demand loan in the guarantee priority of payments is subordinated to covered bondholders.
Reserve fund	Established in the GIC account to trap available revenue receipts or to credit the remaining proceeds of a term advance if ANZNZ's short-term rating falls below 'F1+'. The reserve fund amount will cover the interest amount due on a rolling three-month basis and one-quarter of anticipated annual programme fees.
Selected asset required amount	The amount of assets that can be sold for any one bond is contractually restricted to that bond's pro rata proportion of the committed amount of OC. This restriction is so that earlier-maturing covered bonds cannot use additional cover pool assets over and above their pro rata allocation to the detriment of later-maturing bonds.
Soft-bullet extension	If the issuer fails to pay the final redemption amount of the relevant series of covered bonds on the maturity date (subject to applicable grace periods), then payment of the unpaid amount pursuant to the covered bond guarantee that cannot be paid by the CBG on the final bond maturity date shall be automatically deferred for 12 months after the bond maturity date. Any amount representing the final redemption amount due and remaining amount unpaid on the extension determination date may be paid by the CBG on any interest payment date thereafter, up to the relevant extended due for payment date.

Source: Fitch Ratings, ANZNZ

List of Outstanding Mortgage Covered Bonds

Series	Rating	Currency	Size(m)	Type	Coupon rate (%)	Payment frequency	Maturity	ISIN
2015-1	AAA	EUR	750	Soft	0.625	Annual	Jan 22	XS1171526772
2016-1	AAA	EUR	1,000	Soft	0.125	Annual	Sep 23	XS1492834806
2019-1	AAA	EUR	750	Soft	0.500	Annual	Jan 24	XS1935204641

Source: Fitch Ratings, ANZNZ

New Zealand Legislative Covered Bonds Framework

The table below is based on Fitch's understanding of aspects of the applicable regime and programme structure and is not a substitute for the original texts or New Zealand legal advice.

Main Characteristics of New Zealand Legislative Covered Bonds

Issuer	New Zealand-based registered domestic bank or a subsidiary that is guaranteed by such bank.
Supervision	The RBNZ serves as the regulator under the covered bond framework. Responsibilities and authority include determining registration of the covered bond programme, the publication and maintenance of the public register of covered bond programmes and monitoring that reporting requirements are met.
CBG requirements	A bankruptcy-remote SPV in the form of a trust or a bankruptcy-remote special-purpose company incorporated in New Zealand.
Eligible assets	• Residential mortgage loans with a maximum maturity not exceeding 30 years. • Substitute assets in the form of New Zealand-dollar deposits, certificates of deposit, long-term debt obligations and short-term obligations of a maturity of one year or less, and New Zealand dollar-denominated government securities. This is limited to a maximum 10% of total trust assets for ANZNZ.
Regulatory limit	The RBNZ has imposed a regulatory limit on the issuance of covered bonds by New Zealand banks. No more than 10% of the issuer's banking group assets can be cover assets.
AP	Lowest of either the maximum AP of the programme or other such percentage as notified to the security trustee on the determination date.
ACT	Adjusted collateral value of each loan in the pool, capped at the lower of 80% of the indexed value of the property securing the mortgage and the AP.
Protection against mismatches	Mismatches addressed via contractual arrangements; that is, a 12-month maturity extension on soft-bullet bonds and a 12-month pre-maturity test on hard-bullet bonds.
Interest rate and currency risks	Interest rate and currency mismatches are hedged through swaps the CBG enters into with a suitably rated counterparty. Should the counterparty be downgraded below 'A' or 'F1', swap collateral will be posted according to the credit support agreement. Swap documentation stipulates rating triggers for the replacement of the swap counterparty.
Treatment of swap counterparties	Swap counterparties rank pari passu with covered bondholders in the post-enforcement priority of payments; termination payments due to counterparty default are subordinated to covered bond interest.
Bankruptcy remoteness	• SPV model used – contractually achieves asset segregation from the issuer's insolvency estate through the "true sale" of the mortgage assets to the SPV by way of silent assignment to the CBG. Upon title perfection, full legal title to the underlying mortgages will be transferred. • Asset pool unavailable to any other creditor of the issuer until the claims of the preferred creditors are met. • Preferred creditors to retain an unsecured claim against the issuer if claims are not fully satisfied from the pool.
Title perfection events	• An issuer default event and service of a notice to pay. • The sale of mortgages to a third party, other than the seller. • By order of a court. • Where the security trustee or bond trustee believes the assets are in jeopardy. • Termination of the issuer's or seller's role as servicer. • Seller requesting perfection of sale. • An insolvency event in relation to the seller. • The seller's IDR falls below 'BBB-'
Asset monitor	Qualified and licenced audit firm of national standing in New Zealand to verify the accuracy of the ACT, the amortisation test and the register of cover assets.
Alternative manager	No alternative or dedicated independent manager appointed upon issuer insolvency. The CBG is obliged to select and sell assets with the assistance of a sales advisor to make repayment of the covered bonds. In the event of a CBG default, the security trustee has the power to appoint a receiver, whose duties are prescribed by the specific programme documents.

Source: Fitch Ratings

Appendix 2: Programme Counterparties

Important Features of Counterparties

Role	Counterparties	Issuer default Ratings
Issuer	ANZ New Zealand (Int'l) Limited	Not rated
Issuer	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Seller	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Originator	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Servicer	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Intercompany loan provider	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Interest rate swap provider	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Calculation manager	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Account bank	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Covered bond swap counterparty	ANZ Bank New Zealand Limited	AA-/Stable/F1+
Trust manager	ANZ Capel Court Limited	Not rated
Security trustee	New Zealand Permanent Trustees Limited	Not rated
Bond trustee	Deutsche Trustee Company Limited	Not rated
CBG	ANZNZ Covered Bond Trust Limited	Not rated
Cover pool monitor	KPMG	Not rated
Principal paying agent	Deutsche Bank AG, London Branch	BBB/Evolving/F2

Source: Fitch Ratings, ANZNZ

Appendix 3: Other Payment Continuity Risk Considerations

Asset Segregation

Fitch expects that ringfencing of the cover pool will be effective taking into account the all-or-nothing nature of this risk. The ringfencing of cover assets from the claims of unsecured creditors of the defaulted financial institution is achieved by virtue of law – often in the form of an exemption to normal bankruptcy legislation or through a transfer of the assets to a bankruptcy-remote SPV acting as a guarantor of the issued covered bonds.

Asset Segregation: No Impact on PCU

Component driver	Fitch assessment
Segregation of cover pool from other creditors of issuer	SPV model used – contractually achieves asset segregation from the issuer's insolvency estate through the "true sale" of the mortgage assets to the SPV by way of statutory assignment to the CBG. Upon title perfection, which can occur at the earlier of an issuer event of default, an impending sale to a third party or upon a downgrade of the seller's IDR below 'BBB-', full legal title will be transferred to the CBG.
Excess OC immune from claims from other creditors	Excess OC in the covered bond programme is funded through the use of a demand loan provided by ANZNZ. Repayment of the demand loan ranks junior in repayment to the covered bondholders. As a result, Fitch gives credit to excess OC in its analysis.
Asset and liability clawback risk	Clawback risk on the cover assets is mitigated through the provision of a solvency certificate at the time of sale into the trust. There is no structural feature to mitigate the clawback risk on covered bond payments. However, the programme documentation does not include clawback amounts as part of the guaranteed amounts that the CBG is contractually required to pay. Furthermore, the insolvent transaction test period under New Zealand law covers broadly two years before an insolvency event. Notwithstanding this, Fitch views the risk of clawback on liability amounts as remote.
Commingling risk	ANZNZ currently provides the GIC account. In the event that its rating falls below a Short-Term IDR of 'F1' or a Long-Term IDR of 'A', the GIC account will be replaced within 30 days with a financial institution rated at least 'F1' and 'A'. Commingling risk on the mortgage collections is sufficiently addressed by security over the collection account in the name of the CBG, which should remain bankruptcy-remote in the event of issuer insolvency. It is also mitigated through the transfer of the collections to the GIC account within two days of receipt if the servicer's rating falls below a Short-Term IDR of 'F1' or Long-Term IDR of 'A'.
Set-off risk for deposits	Risk of set-off is limited by the borrower's mortgage agreements, where security is taken directly over the borrower's property, which does not allow the borrower any rights of set-off. Furthermore, upon the downgrade of ANZNZ below 'BBB-', notice will be given to the borrowers of the sale, transfer and assignment of the loans and related security to the CBG. As a result, legal set-off rights that a borrower may have will crystallise and no new rights of set-off can occur.

Source: Fitch Ratings

Alternative Management

Systemic Alternative Management

Fitch takes into consideration the framework or contractual clauses governing the appointment of a substitute manager: the length of time required to appoint one; any potential conflict of interest (in cases where a single administrator in a bankruptcy takes care of covered bonds and other creditors); the manager's responsibilities in the servicing and liquidation of the cover assets to meet payments due on the covered bonds; and any further protection due to oversight or potential support for regulated covered bonds.

The otherwise achievable PCU for the programme will be reduced by one notch if it is in the one-to-three-notch range and by two notches if it is in the four-to-eight-notch range if Fitch assesses that systemic alternative management represents a high risk to payment continuity.

Systemic Alternative Management: No Impact on PCU

Component driver	Fitch assessment
Does the administrator take exclusive care of covered bondholders and when is the administrator appointed?	The CBG is appointed at programme inception. After an issuer event of default, it is upon the CBG to make arrangements in the interest of covered bondholders in accordance with the programme documents. The security trustee can appoint an administrator where there is a covered bond event of default by the CBG or where the cover assets become enforceable.
Importance of timeliness of payments in the legal provisions	The CBG is required to ensure timely payment of the covered bonds following a switch of recourse to the cover pool. ANZNZ acts as servicer and will be replaced if its Long-Term IDR falls below 'BBB-'. If the servicer defaults, it needs to be replaced immediately with a qualified substitute servicer appointed by the CBG. However, until one is appointed, the CBG must act as servicer.
Substitute manager able to sell cover assets or borrow to make timely payments	The CBG's obligations may involve a decision regarding the sale of all or part of the cover pool assets. This involves the appointment of a sales advisor to manage the asset sale on behalf of the CBG. A sales advisor can be an investment bank or an accountant of recognised standing that will have incentives to achieve the highest possible market price available at that time.
Regulatory oversight	Regulated by RBNZ (see Appendix 1)

Source: Fitch Ratings

Cover Pool-Specific Alternative Management

Fitch focuses on the likely ease of the transferability of relevant data and IT systems to an alternative manager and buyer, with such quality and ease also judged on the quality and quantity of data provided to Fitch.

Fitch will lower the programme PCU, which is driven by its liquidity protection, by one notch if the otherwise achievable PCU is in the one-to-three-notch range and by two notches if it is in the four-to-eight-notch range if the agency believes cover-pool-specific alternative management is a high risk. Fitch will also reflect a greater link to the Long-Term IDR of the issuing institution.

Cover Pool Alternative Management: No Impact on PCU

Component drivers	Fitch assessment
Cover assets, debtors' accounts and privileged swaps clearly identified within IT systems	Adequate IT systems and processes are in place, which allow for the identification of cover assets and swaps belonging to the covered bond programme.
Standardised or custom-made IT systems used	Fitch regards the IT systems employed by ANZNZ (Deloitte's ABS suite) to be less challenging for an alternative manager, as they are more standardised compared with internally developed systems. It is a highly functional automated-market developed system, performing the calculations and reporting required for ANZNZ to manage its covered bond programme.
Automation and speed of cover-pool reporting	ANZNZ provides data that is considered adequate and within Fitch's requirements, with only a small amount of data missing.
Adequate filing of loan documentation, evidence of security	Fitch considers the filing of loan documentation as satisfactory.

Source: Fitch Ratings

Appendix 4: Origination and Servicing

Origination and Underwriting

Mortgage applications are originated through four main channels: bank branches, brokers, mobile managers and business banking. The branch network accounts for 55% of mortgage originations, third-party brokers make up 37% and the remainder is introduced through mobile managers and approved mortgage advisors.

Loan applications are processed through a credit decision system, which uses scorecards at the initial application stage to assess the borrower's likelihood of default or payment. An affordability calculator is also used to determine a borrower's capacity to service a loan. All borrower income is verified by an employer letter, direct credit payments, tax returns or payslips. Applicants must demonstrate an acceptable credit history, employment, evidence of genuine savings and satisfy a minimum disposable income level after all commitments, including the proposed housing loan. An approved lending officer manually assesses loan applications that are not system approved. The lending system provides a recommendation to the lending officer assessing the loan and once conditions are met, the lending officer grants approval. No brokers are involved in the credit-assessment process. Lending approval authority is commensurate with experience and built into the bank's loan approval system.

Higher authority levels are required for larger mortgage loans and those with higher LVRs. All applications must comply with ANZNZ's documented credit policy and procedures. The credit policy includes procedures for approving loans deemed to be exceptions, which are assessed on a lending-principles basis. This also requires a higher authority level. A sample of approved mortgage applications is reviewed monthly to ensure authorised lending officers are adhering to the credit policies and procedures.

Servicing

In addition to the lending service centres, ANZNZ has approximately 127 New Zealand-based and 54 Manila-based staff in collections and recovery management. Their role is to prevent, rehabilitate or recover on retail lending products, including residential housing loans. Collection operations have two customer-facing teams located in Wellington and Auckland, as well as two call centres. ANZNZ collections call centres take outbound and inbound calls for mortgage holders in the 1-60 day delinquency period.

Mortgage collections begin on day one for high-risk customers. Early day collection strategies are developed on products and risk, and use a combination of phone calls, dialler, SMS and letters to attempt contact. If not resolved through these strategies, customers are centralised into recovery management for specialised, intensive-relationship management; generally from day 60. Identified hardship cases are referred to recovery management. Applications for any loan term/contract changes are assessed and, if approved, brought in for centralised management until hardship monitoring is completed. The bank works with external agencies, such as budgeting service firms, to help customers find a solution or to minimise losses.

If arrangements or repayment plans cannot be agreed with borrowers in arrears, a formal legal process begins between 90 and 120 days delinquent, when a Property Law Act (PLA) notice is issued to the borrower. At the expiry of the PLA notice, the mortgagee sale can proceed, providing no further action has been taken by the borrower to clear the arrears amount.

The bank monitors the quality of its operations via an operational risk assessment process. Each quarter, internal risk and compliance staff review randomly selected loan files and record any incidents in a central quality reporting unit. The bank also uses this review process to ensure compliance with the New Zealand Credit Contracts and Consumer Finance Act.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.