# 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 | n.a. |
| PCU | 6 |
| Tested rating on a PD basis | AA+ |
| Recovery uplift | 1 |
| Covered bonds rating | AAA/Stable |
| AP Fitch considers in analysis (%) | 64.5% |
| AAA breakeven AP (%) | 90% |

### Key Data

| Key Data | End-July 2017 |
|---|---|
| Asset type | Residential mortgages |
| Maturity profile of bonds | Hard/soft bullet |
| Cover assets (NZDbn) | 10.1 |
| Covered bonds (NZDbn equivalent) | 5.1 |
| Nominal OC (%) | 98.8 |
| WAL of assets (years) | 12.0 |
| WAL of liabilities (years) | 3.4 |

### PCU Reduction

| Asset segregation | No |
|---|---|
| Alternative manager | No |

### Rating Constraint

| None |
|---|

### Related Research

ANZ Bank New Zealand Limited (August 2017)
ANZ Bank New Zealand Limited – Ratings Navigator (July 2017)
APAC Covered Bonds Quarterly – 2Q17 (August 2017)
Covered Bonds Surveillance Snapshot (July 2017)
'B' Portfolio Loss Rates for Covered Bonds (September 2017)

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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 an asset percentage (AP) of 64.5% that Fitch Ratings considers in its analysis, which provides more protection than the agency's 'AAA' breakeven AP of 90%. The four-notch buffer against a downgrade of the bank's IDR supports a Stable Outlook on the rating.

**Dual Issuance Platforms:** The NZD5.1 billion equivalent of covered bonds outstanding is mainly euro-denominated – but includes an issuance in Swiss francs – and was issued through ANZ New Zealand (Int'l) Limited (ANZNIL), a guaranteed issuing vehicle that is a 100%-owned international funding arm of ANZNZ, although the latter can also issue covered bonds. Currency mismatches are hedged with ANZNZ.

**PCU Reflects Liquidity Protection:** The PCU of six notches reflects the strength of liquidity protection for principal payments via a 12-month extension period on the soft-bullet bonds, which make up the majority of outstanding covered bonds. There are interest-protection provisions in the form of a reserve that will cover interest payments and senior expenses on a rolling three-month basis.

**Recovery Uplift Capped:** The recovery uplift is capped at one notch as Fitch believes foreign-exchange (FX) risk could materially affect recoveries should the covered bonds default. This is because the assets are denominated in New Zealand dollars while all outstanding covered bonds are either denominated in euros or Swiss francs. There are liability swaps in place, but we expect these to terminate upon a bond default so that longer-dated New Zealand dollar asset cash flows will provide recoveries in a different currency than that of the bonds.

**Asset Disposal Drives AP:** The 'AAA' breakeven AP of 90% equates to a breakeven overcollaterisation (OC) of 11.1%. The 11.8% asset disposal loss reflects maturity mismatches with a weighted-average (WA) asset residual life of 12.0 years, compared with 3.4 years for the bonds and a potential need to sell assets for timely payment. The cash flow valuation component lowers breakeven OC by 5.0%, as Fitch models excess spread for the programme. The credit loss component is 4.1%.

## Programme Highlights

**Consistent Cover-Pool Credit Quality:** The cover pool comprises of New Zealand residential mortgages of NZD10.1 billion at end-July 2017. The WA loan/value ratio (LVR) was 52.0% (Fitch-calculated indexed WA LVR: 46.1%). Fitch's 'AAA' cumulative WA frequency of foreclosure (WAFF) for this pool is 15.2% and the WA recovery rate (WARR) is 67.9%.

**Flexi Loans Increase Risk:** Loans linked to a flexible loan product – an at-call secured credit line – make up 36.7% of the cover pool. Flexi loans are excluded from the cover 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-/ Stable | AAA/ Stable |
| Bank of New Zealand | AA-/ Stable | AAA/ Stable |
| Kiwibank Limited | AA-/ Stable | AAA/ Stable |
| Westpac New Zealand Limited | AA-/ Stable | AAA/ Stable |

Source: Fitch

## Peer Comparison

The table below compares the key rating drivers for ANZNZ with those of the four other regulated programmes issuing 'AAA' New Zealand covered bonds by banks rated 'AA-'/Stable by Fitch. The selected peers are listed in the table in the left margin.

ANZNZ's cover pool has a slightly higher credit risk profile than the peer average because of the existence of loans linked to flexi loans (an at-call secured credit line), which made up 37% of the cover pool as of end-June 2017. Please see the *Covered Bond Surveillance Snapshot (July 2017)* and the 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-/Stable |
| IDR uplift | 0 | 0 | 0 |
| PCU | 6.0 | 5.3 | 3.0 – 6.0 |
| 'B' portfolio loss rate (%) | 0.2 | 0.6 | 0.3 – 0.7 |
| 'AAA' breakeven OC (%) | 90.0 | 89.5 | 87.5 – 90.5 |
| Breakeven OC components (%) | | | |
| Credit loss (%) | 4.1 | 3.7 | 3.5 – 3.9 |
| Cash flow valuation (%) | -5.0 | -7.0 | (8.2) – (6.3) |
| Asset disposal loss (%) | 11.8 | 14.1 | 11.7 – 16.7 |

Source: Fitch; data as at 17 July 2017

## Country Risk Impact

This section does not apply as the programme is not affected by country risk. This is because its 'AAA' rating is in line with New Zealand's Country Ceiling and is the maximum rating achievable. Please see *Criteria for Country Risk in Global Structured Finance and Covered Bonds*.

## Sensitivity Analysis

There is limited downward pressure on the 'AAA' rating for ANZNZ's mortgage covered bonds. The PCU of six notches plus the one-notch recovery uplift means ANZNZ's covered bond ratings are likely to remain unchanged unless ANZNZ's IDR falls below 'BBB+'. There is also a substantial cushion between Fitch's breakeven AP of 90% and the nominal AP of 64.5% that the agency gives credit to in its analysis (highest nominal AP in the last 12 months). Furthermore, the rating on the covered bonds would remain unaffected if the nominal AP in the programme rises to the maximum 90% contractual AP stipulated in the programme documents, given that this figure is in-line with the Fitch-calculated breakeven AP.

### Related Criteria

Covered Bonds Rating Criteria (October 2016)

Global Bank Rating Criteria (November 2016)

Structure Finance and Covered Bonds Counterparty Rating Criteria (May 2017)

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (May 2017)

Fitch's Cover Asset Refinancing Spread Level (RSL) Assumptions - Excel File (January 2017)

APAC Residential Mortgage Criteria (July 2017)

**Abbreviations**

AP: Asset Percentage
PCU: Payment Continuity Uplift
IDR: Issuer Default Rating
OC: Over Collateralisation
PD: Probability of Default
WAL: Weighted-Average Life
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 its oldest, having 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 NZD155.8 billion and a domestic market share of approximately 31% of total registered banking assets as at end-March 2017. 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 ANZNIL, a guaranteed issuing vehicle used for international funding by ANZNZ.

Fitch's most recent reports on ANZNZ's bank ratings are an *Update* (August 2017) and *Ratings Navigator* (July 2017).

## IDR Uplift: Zero Notches

An IDR uplift of zero notches applies for all New Zealand covered-bond programmes rated by Fitch. New Zealand's open bank resolution framework allows for the bail-in of creditors and does not explicitly exempt covered bonds. In the case of statutory management of an issuer, Fitch understands there is a risk of direct enforcement of the recourse against the cover pool and the IDR remains a satisfactory indicator of the likelihood of this occurring.

## 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 majority of covered bonds outstanding, as well as three-months' interest protection in the form of a reserve to be funded upon the loss of ANZNZ's Short-Term IDR of 'F1+'. The hard-bullet bonds, which in the agency's view offer less liquidity protection than the soft-bullet bonds due to the pre-maturity test having a cure period of up to six months, are not considered material to the PCU, as they make up less than 8% of bonds outstanding and Fitch expects them to be repaid by ANZNZ within the next 12 months at maturity.

None of the other factors influencing payment continuity analysed by Fitch (see Appendix 2) represent a high risk, which in Fitch's view would be otherwise reflected in a PCU reduction.

## Recovery Uplift: One-Notch

The recovery uplift on the rating is capped at one notch, as Fitch believes FX risk could have a material impact on recoveries given a default of the covered bonds. This is because the cover assets are denominated in New Zealand dollars while all the covered bonds outstanding are denominated in euros and Swiss francs. In a default scenario, Fitch expects the covered-bond swap will be terminated so the longer-dated asset cash flows would provide recoveries in a different currency than the covered bonds. This could lower recovery expectations.

### Default Model Output (%)

| Rating level | WAFF | WARR | WA MVD | Loss rate |
|---|---|---|---|---|
| AAA | 15.2 | 67.9 | 61.8 | 4.9 |
| AA+ | 13.9 | 71.9 | 58.5 | 3.9 |
| AA | 12.6 | 76.0 | 55.3 | 3.0 |

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

Source: Fitch

## Cover Pool

### ANZNZ's Cover Pool

**Characteristics as of end-May 2017**

| **General** | | **Geographical breakdown (%)** | |
|---|---|---|---|
| Current principal balance (NZDbn) | 10.1 | Auckland | 51.8 |
| Number of loans | 55,394 | Christchurch | 11.5 |
| Number of loan groups | 37,431 | Wellington | 10.8 |
| Average loan group size (NZDbn) | 269,521 | Waikato | 8.3 |
| WA seasoning (months) | 34.6 | Bay of Plenty | 4.2 |
| WA interest rate (%) | 4.7 | Otago | 3.7 |
| WA remaining term to maturity (years) | 19.6 | Manawatu-Wanganui | 2.6 |
| WA current LVR (%) | 52.0 | Hawke's Bay | 1.9 |
| Fitch WA indexed current LVR (%) | 46.1 | Nelson | 1.7 |
| Maximum loan group balance | 1,969,174 | Northland | 1.6 |
| Interest only (%) | 13.2 | Taranaki | 1.0 |
| Investment property (%) | 34.8 | Gisborne | 0.5 |
| Loans associated with flexi loans (%) | 36.7 | West Coast | 0.4 |
| | | Southland | 0.1 |
| **Substitute assets** | | | |
| Cash in GIC account (NZD million) | 0 | | |
| | | Loan arrears (%) | |
| **Loan type (%)** | | >30 days and <= 60 days | 0.1 |
| Fixed | 87.0 | >60 days and <=90 days | 0.1 |
| Variable | 13.0 | >90 days | 0.0 |

Source: ANZNZ, Fitch

## Cover Pool Credit Analysis

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

The cover pool's credit risk profile has remained stable over the past 12 months. The cover pool comprised of 55,394 individual loans, with an aggregate outstanding amount of NZD10.1 billion as of end-July 2017. All loans are secured by a first-ranking mortgage. The WA current LVR was 52.0% and the WA seasoning of the mortgage loans was 34.6 months. Interest only loans formed 13.2% of the pool. Fitch considers all loans collateralised by multiple properties as investment loans, which comprise 34.8% of the loan portfolio under this methodology. The cover pool is geographically diversified across New Zealand, with the largest concentration by balance in Auckland (51.8%), followed by Christchurch (11.5%).

Currently, 37% of the cover pool is linked to a flexible loan product – an at-call secured credit line – linked 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 homebuyers 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.

Further advances are permitted as long as the loans satisfy the programme's eligibility criteria. As such, the agency adjusts the PD across the cover pool by 5%.

According to Fitch's methodology, the two key components of the PD on the residential loans are the willingness and ability of a borrower to make payments on the loan. Willingness to pay

is usually measured by the current LVR: higher default probability 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 makes a conservative assumption based on the originator's underwriting standards and market information. In this case, it increased the PD on the loans by 20%, corresponding to a Fitch debt burden-to-borrower income class of 5 (35% to 40%).

Fitch further adjusts the PD to account for borrower- and asset-specific characteristics. The recovery rates are mainly driven by market value decline (MVD) assumptions.

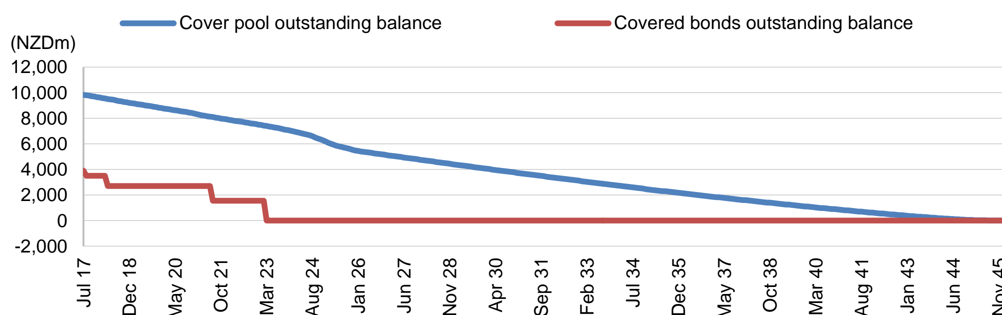
Fitch derived a stressed cumulative default rate and recovery rate for the cover pool based on the loan-by-loan analysis of the cover assets and taking into account the features of the mortgages. In a 'AAA' rating scenario, the WAFF equated to 15.2% and the WARR to 67.9%, which is equivalent to an expected loss rate of 4.9% (see the *Default Model Output* table).

## Cash Flow Analysis

Fitch's cash flow model simulates the asset cash flows 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% is sufficient to withstand the agency's 'AA+' tested rating on a PD basis under the covered bonds cash flow model.

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

**Amortisation Schedule**




Source: Fitch/ANZNZ

### Maturity Mismatches

The cover assets are amortising, with an average remaining maturity of 12.0 years, while the covered bonds have an average residual maturity of 3.4 years. As a result, temporary liquidity surpluses or shortfalls may arise, putting a strain on 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 12-month maturity extension on the majority of 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 that earlier-maturing covered bonds cannot use additional cover pool assets over and above their pro rata allocation to the detriment of later-maturing ones. Fitch replicated this feature in its cash flow modelling of this programme.

To determine the stressed price at which such asset sales would occur, Fitch assumed a refinancing cost (shown below) for any potential buyer. However, due to the lack of 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

### *Criteria Variation*

Fitch has applied a variation to the refinancing spread level (RSL) assumptions for New Zealand, which provide for refinancing stress on standard mortgage cover assets simulating their sale to meet covered bond payments.

Flexi loans are linked to the same secured property as the cover assets and, in the event of the cover assets being sold, the flexi-loans would also need to be sold. Fitch believes these additional line-of-credit loans increase the programme's refinancing costs, as they could be more difficult to sell to a third-party as they are not a standard product across New Zealand. It also increases the amount of loans needed to be sold, potentially affecting the sale price of the cover assets.

To reflect the additional refinancing risk posed by the flexi loans linked to some cover pool assets in the programme, Fitch considered an additional stressed refinancing rate differential of 100bp above New Zealand's base mortgage refinance stresses for cover assets linked to the flexi loans. As a consequence, in a 'AA+' stress scenario, Fitch tested cash flows for timely payment at the 'AA+' tested rating on a PD basis by applying an RSL of 334bp for the portion of the asset pool with associated flexi loans. This results in overall RSL for the entire pool of 271bp, instead of 234bp, based on the pro rata value of the cover assets linked to flexi loans. This constitutes a variation to Fitch's RSL assumptions for New Zealand, but does not affect the ratings of ANZNZ's covered bonds.

## Hedging

The covered bond guarantor (CBG) has entered into an interest-rate swap agreement with ANZNZ to swap the interest paid on the loans into BKBM plus a margin every 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 interest-rate swap and those due on the foreign-currency-denominated covered bonds. The covered-bond swaps in place are forward-starting; 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. No FX stresses are applied, as the programme is hedged until the maturities of the liabilities, inclusive of any extension period.

**Summary of Hedging in Programme**

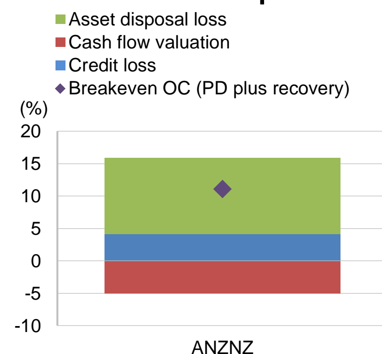
| Swap type | Currency | (%) | Swap provider | Rating |
|---|---|---|---|---|
| Fixed-floating assets | No | 100.0 | ANZNZ | AA-/Stable/F1+ |
| Fixed-floating liability | Yes | 100.0 | ANZNZ | AA-/Stable/F1+ |

Source: Fitch/ANZNZ

The cover assets, which are a mix of fixed- and variable-rate mortgages, are hedged with a total-return swap provided by ANZNZ. Fitch models the lower of the swap margin for the fixed-rate mortgage loans 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 we do not expect the total-return swap to be replaced for these products.

Fitch models all liabilities with floating rates in New Zealand dollars, as this is their post-swap status and all swap documentation entered into provides mitigants to counterparty risk in-line with Fitch's criteria, including the swap counterparty having to post collateral for its obligations, should it be downgraded below certain rating levels, or replacement of the swap counterparty.

**Breakeven OC Components**




Source: Fitch

## Breakeven AP for the Rating

Fitch calculated a 'AAA' breakeven AP of 90%, which equates to an OC of 11.1%. 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 cover pool changes.

The equivalent 'AAA' breakeven OC of 11.1% is mainly driven by the asset disposal loss component of 11.8% due to the significant maturity mismatches between the cover assets and covered bonds analysed, with a WA life of 12.0 years and 3.4 years, respectively. The credit loss component contributes 4.1% and the cash flow valuation component decreases breakeven OC by 5% due to available excess spread modelled by Fitch in the programme based on a stressed WA life of the assets of 6.7 years, inclusive of prepayments, versus the life of liabilities of 3.7 years, inclusive of the extension period on the soft bullets. 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 into account in its analysis the highest nominal AP (64.5%) of the previous 12 months. While excess OC is secured by a demand loan back to the issuer, the repayment of the demand loan ranks junior in repayment to covered bondholders. Therefore, Fitch can give credit to OC in excess of the AP reported in the ACT.

# Programme Review

Fitch will periodically review 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 bonds information is updated on a quarterly basis and displayed on Fitch's covered bond surveillance tool (available at www.fitchratings.com) and in the quarterly *Covered Bonds Surveillance Snapshot*.

# Disclaimer

References in this report to the content and impact of relevant legislation and/or regulation represent Fitch's interpretation. Fitch relies, in its credit analysis, on legal opinions or memoranda provided by issuers' and/or other outside legal counsel. As Fitch has always made clear, Fitch does not provide legal advice or confirm that a country's legal or regulatory framework, the legal opinions or memoranda, or any other programme documents or any structures are sufficient for any purpose. The disclaimer at the foot of this report makes it clear that this report does not constitute legal, tax and/or structuring advice from Fitch, and should not be used or interpreted as legal, tax and/or structuring advice from Fitch. Should readers of this report need legal, tax and/or structuring advice, they are urged to contact relevant advisers in the relevant jurisdictions.

## Appendix 1: Programme Summary

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, as required under the Reserve Bank of New Zealand (Covered Bonds) Amendment Act 2013, on 8 August 2014.

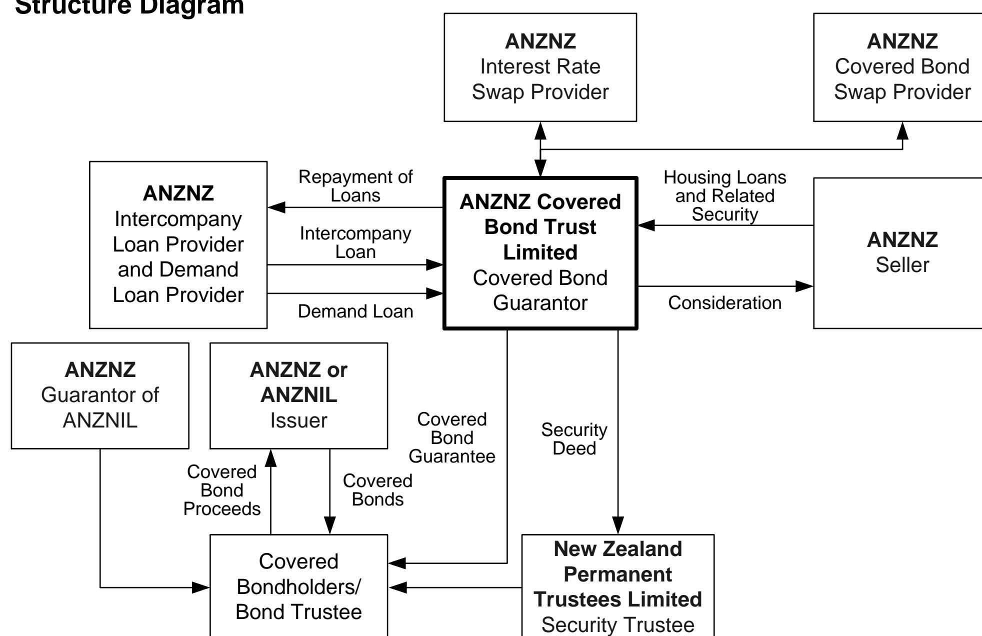
As long as ANZNZ is solvent, the bank and ANZNIL will pay covered bond obligations when due pari passu among themselves and with their senior liabilities, irrespective of cover asset performance, as they are direct, unconditional, unsecured and unsubordinated obligations of the issuers. On a second recourse, 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 main body of this report.

### Main Parties

| Role | Counterparties | Issuer Default Ratings |
|---|---|---|
| **Issuer** | ANZ Bank New Zealand Limited | AA-/Stable/F1+ |
| **Seller/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+ |
| **Covered-bond swap provider** | ANZ Bank New Zealand Limited | AA-/Stable/F1+ |
| **Guarantor** | ANZ Bank New Zealand Limited | AA-/Stable/F1+ |
| **Account bank** | ANZ Bank New Zealand Limited | AA-/Stable/F1+ |
| **Issuer** | ANZ New Zealand (Int'l) Limited | Not rated |
| **CBG** | ANZNZ Covered Bond Trust Limited | Not rated |
| **Trust manager** | ANZ Capel Court Limited | Not rated |
| **Bond trustee** | Deutsche Trustee Company Limited | Not rated |
| **Security trustee** | New Zealand Permanent Trustees Limited | Not rated |
| **Principal paying agent** | Deutsche Bank AG, London Branch | A-/Negative/F1 |
| **Asset monitor** | KPMG | Not rated |

Source: Fitch, programme documents

### Structure Diagram




Source: Programme documents

## ANZ Bank New Zealand Limited Mortgage Covered Bonds

| Structural feature | Explanation |
|---|---|
| Covered Bond Guarantee | Provides credit support to the issuer and the guarantor in the case of ANZNIL. |
| Pre-maturity test | Provides liquidity to the CBG in relation to amounts of principal due on the final maturity date of the hard-bullet covered bonds. It is triggered when ANZNZ's short-term IDR falls below 'F1' and when the final maturity date of the series of hard-bullet covered bonds falls in the period commencing 12 months prior to the final maturity date of the relevant series of hard-bullet covered bonds.<br>If the pre-maturity test is breached, after a cure period of up to six months the CBG may be obliged to sell mortgage loans and the related security to make the redemption. If the test is breached and funds in the GIC account are insufficient to redeem hard-bullet bonds subject to the pre-maturity test, an issuer event of default will occur. |
| 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.<br>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 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.<br>Failure to pass the amortisation test will trigger a CBG event of default, which allows the bond trustee to serve a covered bond guarantee acceleration notice. The CBG will be obliged to sell the loans and proceeds will be used to repay, pro rata, the outstanding covered bonds. The amortisation test mitigates time subordination of covered bonds within the programme. |
| 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 IDR falls below 'F1+' |
| 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 ones. |
| Soft bullet extension | If the issuer fails to pay the final redemption amount of the relevant series of soft-bullet 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: Programme documents

## List of Outstanding Mortgage Covered Bonds

| Series | Rating | Currency | Size(m) | Type | Coupon rate (%) | Payment frequency | Maturity | ISIN |
|---|---|---|---|---|---|---|---|---|
| 2012-2 | AAA | CHF | 300 | Hard | 1.500 | Annual | Feb 18 | CH0149182450 |
| 2012-3 | AAA | EUR | 750 | Soft | 1.375 | Annual | Oct 17 | XS0830360524 |
| 2013-1 | AAA | EUR | 500 | Soft | 1.500 | Annual | Oct 18 | XS0973586059 |
| 2015-1 | AAA | EUR | 750 | Soft | 0.625 | Annual | Jan 22 | XS1171526772 |
| 2016-1 | AAA | EUR | 1000 | Soft | 0.125 | Annual | Sep 23 | XS1492834806 |

Source: ANZNZ

## Appendix 2: Other Payment Continuity Risk Considerations

### Asset Segregation

Fitch expects that ringfencing of the cover pool will be effective given the 'all or nothing' nature of this risk. The ring-fencing of cover assets from any claims from 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 special purpose vehicle (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 silent 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 can occur at any time, for as long as the ACT is not breached by the repayment. The demand loan repayment ranks subordinate to covered bondholders in the event of issuer insolvency. |
| Asset and liability claw back 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, 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 its rating falls below a Short-Term IDR of 'F1' or a Long-Term IDR of 'A', the GIC account is to be replaced within 30 days with a financial institution rated at least 'A'/'F1'. Commingling risk 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'. |
| 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

### Alternative Management

#### *Systemic Alternative Management*

Fitch takes into consideration the framework or contractual clauses governing the appointment of a substitute manager – together with 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.

If Fitch assesses that systemic alternative management represents a high risk to payment continuity, the otherwise achievable PCU for the programme will be reduced 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.

### Systemic Alternative Management: No Impact on PCU

| Component driver | Fitch assessment |
|---|---|
| Administrator takes exclusive care of covered bondholders? When are they appointed? | In an issuer event of default, it is upon the CBG to make arrangements in the interest of covered-bond holders in accordance with the programme documents and the security trustee can appoint an administrator where there is a covered bond event of default by the CBG. |
| Importance of timeliness of payments in the legal provisions | Following a switch of recourse to the cover pool, the CBG is required to ensure timely payment of the covered bonds.<br>ANZNZ currently acts as servicer. The servicer will be replaced where its long-term IDR falls below 'BBB-'. If the servicer defaults, it needs to be replaced immediately; the CBG takes on this role until an appropriate servicer is appointed. |
| Substitute manager able to sell cover assets or borrow to make timely payments | The CBG 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 if this were to occur. 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 Reserve Bank of New Zealand (see Appendix 1) |

Source: Fitch

### *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.

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

### 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 in place that allow for the identification of cover assets and swaps belonging to the covered-bond programme. |
| Standardised or custom-made IT systems used | Fitch considers IT systems employed by ANZNZ (Deloitte's ABS suite) to be less challenging for an alternative manager, as they are more standardised as compared with internally developed systems. This system 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

## Appendix 3: 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 39% of mortgage originations, third-party brokers make up 32% and the remainder is introduced through mobile lenders and business managers.

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. Loan applications that are not system approved are manually assessed by an approved lending officer. 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 124 New Zealand-based staff in collections and recovery management, whose 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 as early as day one for high-risk customers. Early day collection strategies are developed based 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.

## Appendix 4: Legal Framework

The table below is based on Fitch's understanding of certain 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 a bank. |
| Supervision | The Reserve Bank of New Zealand 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 special-purpose vehicle 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.<br>• 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. With ANZNZ, this is limited to a maximum 10% of the trust's total assets. |
| Regulatory limit | The Reserve Bank of New Zealand 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 90% 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, notably a 12-month maturity extension on soft-bullet bonds and 12-month pre-maturity tests on hard-bullet bonds. |
| Interest-rate and currency risks | Interest rate and currency mismatches are hedged though swaps entered into by the CBG with a suitably rated counterparty. Should the counterparty be downgraded below 'A'/ 'F1', then 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.<br>• Asset pool unavailable to any other creditor of the issuer until the claims of preferred creditors are met.<br>• Preferred creditors to retain an unsecured claim against the issuer if claims not fully satisfied from the pool. |
| Title perfection events | • An issuer default event and service of a notice to pay.<br>• The sale of mortgages to a third party, other than the seller.<br>• By order of a court.<br>• Where the security trustee or bond trustee believes the assets are in jeopardy.<br>• Termination of the issuer/seller's role as servicer.<br>• Seller requesting perfection of sale.<br>• An insolvency event in relation to the seller.<br>• 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

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