

Operational Guidelines: New Zealand Wholesale Funding Guarantee Facility

1 November 2008

Updated 26 March 2009

Note: Changes since 1 November 2008 are **highlighted**.

Objectives

The wholesale funding guarantee facility is designed primarily to:

- Facilitate access to international financial markets by New Zealand financial institutions, in a global environment where international investors remain highly risk averse and where many other governments have offered guarantees on their banks' wholesale debt.
- Encourage issuers to withdraw from using the guarantee facility, and the Crown to withdraw from offering it, on new issues as soon as the international markets return to normal.

The wholesale guarantees will be given under section 65ZD of the Public Finance Act 1989. Section 65ZG of that Act provides that any money paid under a guarantee given under section 65ZD may be made without further appropriation. This means that in the event of a claim under a guarantee international financial markets can be confident that payment will be made in a timely manner.

Operational Details

All the details below are subject to the overriding provision that the Crown will not be obliged to offer a guarantee facility to any particular issuer or on any particular debt issue.

Which issuers can use the facility?

The facility will be available to financial institutions that have an investment grade credit rating (BBB- or better), and have substantial New Zealand borrowing and lending operations (but not to institutions that are simply financing a parent or related company).

- The scheme does not include non-financial (eg corporate and local authority) issuers. This focus on financial intermediaries is consistent with the approach to wholesale guarantee facilities which has been adopted in other countries.
- Collective investment schemes will not be eligible as guaranteed issuers (although their holdings of guaranteed issues would be covered by the guarantee).

Which instruments would be covered?

All newly issued senior unsecured negotiable or transferable debt securities would be eligible for inclusion¹.

- Any new issues of these instruments by eligible financial institutions, including ones targeted partly or wholly at retail investors, would be eligible for coverage under the wholesale scheme.
- Any retail security, issued under the prospectus requirements of the Securities Act and eligible for coverage under the Crown retail deposit guarantee scheme, would remain covered under the retail deposit guarantee facility, unless the issuer sought a guarantee under the wholesale guarantee facility.
- Any institution signing up to the wholesale guarantee facility will also be required to agree that all securities eligible for a wholesale guarantee (whether actually guaranteed or not) will not be covered under its retail deposit guarantee scheme agreement. An exception will be made for retail bonds, as outlined above.

Which currencies would be covered?

Eligible instruments in all major currencies would be eligible for cover. Specifically, the scheme would cover NZD, AUD, USD, EUR, GBP, CHF, JPY, HKD, and SGD issuance.

- The focus of the scheme is on re-establishing access to foreign funding markets. However, it will also offer cover on New Zealand dollar issuance.
- Including domestic issuance should enable managed funds and other similar entities, over time, to transfer most of their claims on New Zealand registered banks into instruments that are eligible for coverage under a wholesale scheme.
- Covering domestic issuance will also minimise the risk of loss of funds to Australia, and from locally incorporated banks to the local branches of Australian banks (who benefit from the Australian wholesale guarantee, which also covers both NZD and AUD issuance by Australian institutions).
- Applications to cover paper denominated in any other currencies would be considered on a case-by-case basis.

What about branches of foreign banks?

Branches of foreign banks would be included among the institutions eligible for a wholesale guarantee scheme, but only in respect of their New Zealand dollar issuance.

¹ Covered bonds (bonds in which the holder has a claim both against a specific pool of assets as well as a general claim on the issuer) would also be eligible. Other asset-backed securities and subordinated debt issues are explicitly excluded.

- Eligibility would be restricted to those branches' issuance of New Zealand dollar securities to avoid any risk of any New Zealand guarantee supporting the funding of the wider group,

What fees would be charged?

A guarantee fee would be charged for each issue, differentiated by the riskiness of the issuer, **currency** and the term of the security being guaranteed, as follows:

Credit rating of issuer	1 Year or less (bps per annum)	More than 1 year (bps per annum)	
		NZD	non-NZD
AA- and above	70	90	70
A- to A+	130	150	130
BBB- to BBB+	180	200	180

The guarantee fee for new issuance would be reviewed, normally monthly, in the light of market developments and indicators (about pricing and usage) and could be adjusted as required. Adjustments would be made by the Secretary to the Treasury.

The rating used would be the rating applied to the issuing institution without the benefit of any government guarantees.

- The fee schedule has been designed to ensure that the facility is used while it is needed, but to encourage issuers to graduate from using the guarantee as market conditions permit.
- These prices have been set informed by data on the gap between government and private sector borrowing costs in normal times and over the crisis period. In terms of international benchmarks, this scheme would be more expensive than some (eg United States and Australia), and cheaper than others (eg Canada) and around the price of the United Kingdom facility.
- Pricing of the facility will be less expensive for shorter terms reflecting lower market prices for credit risk for shorter terms.
- Issuance patterns and market pricing will be monitored closely, and authority to adjust the fee structure in accordance with the principles that guided the development of the pricing framework would be delegated to the Secretary to the Treasury.
- Any changes in pricing would apply only to issues approved for the guarantee from that point forward.

How long would the guarantee facility continue to be offered?

The guarantee offer for new issues would be withdrawn when market conditions in the key funding markets have returned to relative normality for a sustained period

- There should be no expectation that the guarantee will continue to be offered on new issuance for any fixed or lengthy period. However, the crisis to date has gone in waves, and the guarantee scheme is likely to continue to be offered for some time.
- As market conditions normalise and unguaranteed funds can be raised more readily, at some point it will be cheaper for institutions to issue unguaranteed paper rather than guaranteed paper. Should we judge that that migration was not occurring sufficiently rapidly, in light of our reading of market access conditions, we would have the option to increase the price of the facility.

How long a period would any guarantee cover?

Any paper carrying the guarantee would be covered to maturity or for up to five years from the time it is issued, whichever is the earliest².

- The deposit guarantee scheme has a fixed two year term. By contrast, the wholesale guarantee scheme will cover any paper issued until its maturity or for up to five years, whichever is the earliest. This does not mean that the wholesale scheme will be offered on new issues for five years: it will be offered only until market conditions normalise.
- The difference in the two schemes reflects two considerations. First, most retail deposits are for terms less than two years. Second, it is important that wholesale funding is spread out over a range of maturities to avoid the risk of concentrated rollovers, with associated macroeconomic risks, at some point in the future.

Opt-in or all-encompassing?

The facility would operate on an opt-in basis, by institution and by instrument.

- No financial institution would have to participate in the scheme, nor would all new issues of debt have to be covered. Thus, it is possible that an institution could have two types of otherwise identical instruments on issue, one of which is government guaranteed (with a fee paid to the Crown) and one of which is not government guaranteed. Issuers will be required to disclose whether or not particular paper is government guaranteed.
- This approach will facilitate institutions gradually withdrawing from using the guarantee on new paper, as market conditions allow.

Whose holdings would be covered?

All holders of guaranteed paper would be covered by the guarantee, other than related parties.

² Formal documentation will allow issues to be guaranteed for up to 61 months, to reflect market practice, whereby bonds typically mature on the 15th of the month.

- The retail deposit guarantee scheme excludes deposits held by financial institutions. This exclusion was intended to minimise the extent to which wholesale holdings of financial instruments were covered by the highly concessional deposit guarantee scheme. Under the wholesale scheme there is no need for such a carve-out. Thus, as one example, all holdings of guaranteed paper held by unit trusts and other collective investment schemes would be covered.
- Any debt held by related parties (including parents) of the issuer will not be covered.

How much paper would we be willing to guarantee?

Issuers who joined the wholesale guarantee facility will not be permitted to have guarantees for debt in excess of 125 per cent of the total stock of eligible types of debt on issue prior to the intensification of the crisis³.

- This limit provides the Crown some additional cover against the risk of banks seeking to increase their funding activities solely on the basis of the guarantee.
- It also provides a cap on the risk that NZD issuance undertaken by New Zealand branches of wholesale banks under this guarantee would be used to fund the wider activities of the group.
- No limit has been set on the total volume of paper we would be willing to guarantee. The overall use of the facility will be closely monitored. The pricing of the scheme could be adjusted, for future issues, if more debt is being issued under guarantee than we judge to be necessary in light of market access conditions.

What about the risk that issuers concentrate new issuance in short-term maturities, on which the guarantee fee is cheaper?

We will seek commitments from institutions using the facility that they will seek to lengthen the average maturity of their funding wherever that is possible. Moral suasion and discretion over the pricing of the facility may, if required, be used to reinforce this.

- To avoid any risk of concentrating future rollovers, the pattern of issuance will be monitored closely. The option of adjusting the pricing structure on the guarantee facility provides an important backstop.
- To support this, we will seek assurances that issuers will seek to lengthen the average maturity of their funding where that is possible. This is likely to be seen by issuers as being in their own interests.

³ For banks, as per the last published General Disclosure Statement, and for other issuers the last published set of annual accounts for a period prior to 12 October 2008.

Capital buffer

To protect the interests of the Crown as guarantor, we will establish additional capital buffers for issuing institutions. These will support an expectation that the capital position of an issuer will not be depleted over the period when the guarantee is being offered.

- Registered banks are subject to the full range of Reserve Bank prudential supervisory powers.
- We will impose a requirement that guaranteed locally incorporated registered banks maintain an additional 2 per cent Tier 1 capital buffer, above the 4 per cent regulatory minimum. The banks already hold at least such a buffer, and we would not expect them to reduce that. The additional required buffer will provide additional protection for the Crown's position as guarantor, and no fresh guarantees would be issued if the additional buffer was not being maintained.
- Non-bank applicants would need to be treated on a case-by-case basis.

Information requirements

For any non-bank issuers, additional information and related requirements will be required as part of the guarantee documentation.

- For any non-banks seeking coverage we will have a version of the guarantee deed that provides enhanced information and related powers for the authorities.

Foreign exchange risk

All issuers participating in this guarantee facility will be required to undertake that the foreign exchange risk associated with foreign currency borrowing will be hedged and managed.

Participation in the Crown retail deposit guarantee scheme

Deposit-taking financial institutions seeking to utilise the wholesale funding guarantee facility will be expected to have applied for a guarantee under the Crown retail deposit guarantee scheme.

- In that regard, the Crown does not expect or intend that financial institutions will seek to amend their fundraising activities so as to take advantage of any lower fees payable under the Retail Guarantee. Rather, the Crown's expectations and intentions in entering into the Retail Guarantee include that they will not seek to increase the issuance of debt securities which effectively have the benefit of the Retail Guarantee relative to the issuance of debt securities which might have the benefit of the Wholesale Guarantee, in order to take advantage of the lower fees payable under the Retail Guarantee. Actions inconsistent with this expectation and intention could result in the Crown withdrawing its guarantee under 10.3 of the Retail Guarantee.