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Debt Programs – NZ backs off back-stop

New Zealand has signaled a new direction for commercial paper markets by becoming the first sovereign issuer to shed a back-stop loan facility. Harnessing a striking new liquidity policy as an alternative comfort for investors, the Pacific sovereign has gained the blessings of Moody's and Standard & Poor's for the move.

The US credit rating agencies have insisted previously that all issuers – even sovereigns – must put contingent loans in place as support for their CP. The facilities reassure investors that they will be repaid even if the issuer suffers a liquidity crunch.

New Zealand's new approach will save the country's Debt Management Office in Wellington around US$1m in fees, by "eliminating all requirements for swingline or back-up facilities," according to Alex Jurshevski, head of the portfolio management. Over the remaining life of the US$150m five-year swingline loan which New Zealand, an active Euro and US CP issuer, signed back in the early 1990's. It would have paid 0.125% to its potential lenders each year.

It will also give the sovereign access to its programs' full capacity. Although New Zealand's Euro and US Cp deals carry US$1bn and US$750m ceilings respectively, the DMO had previously agreed with rating agencies that its aggregate outstandings would not surpass US$11m. The agencies based this figure on a requirement of swingline support equal to 15% of maximum outstandings.

The DMO's move follows its adoption earlier this year of a new policy of liquidity management for its offshore liabilities.

Previously it managed its short-term investments and liabilities separately. When combined with a government policy to finance all interest and principal payments on foreign currency debt from New Zealand dollar funds, this miss-match was costing the agency as much as 20bp on a portfolio of some US$700m each year.

Now the DMO has adopted new investment guidelines and interest-rate limits. These restrict its holdings of "illiquid" short term instruments such as repos and bank deposits and set a minimum proportion which it will invest in government paper. Jurshevski declines to reveal full details of the "proprietary" policy.

While allowing the agency to generate gains on its portfolio which it estimates at between 30bp and 40bp annually, the new policy's primary purpose is to maintain a minimum asset level of NZ$1.2bn. This figure can rise higher "dynamically" as redemptions increase but it will not reduce, Jurshevski affirms.

Consequently, DMO senior portfolio manager John Orange argued to credit rating agences its pool provides investors with superior liquidity support. "We said we have a

better arrangement that gives a much better cushion to investors – a better assurance of repayment of principal and interest – than under our previous facility," Jurshevski commented.

Moody's and S&P approved the arrangement in July. Each has since affirmed a top short-term rating on New Zealand's top two programmes.