Debt Securities Conventions

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1. Description

The long dated securities market in Australia involves issuing and trading in commonwealth government securities (CGS), state and territory Government securities (Semi's), other public authority securities (including Australian dollar securities issued by some supranational organisations), and corporate bonds.

The long dated securities market plays a key role in the financial system:

- It provides a fund raising medium for governments and for companies
- It provides investments for banks, life offices and pension funds, other financial intermediaries and companies
- The Reserve Bank of Australia (RBA) also has a portfolio of CGS and trades in these as part of its monetary and liquidity management
- The yields on CGS serve as a benchmark for other interest rates in the financial community

2. Products

A fixed interest security is a financial instrument that creates the obligation for the issuer to pay:

- a fixed sum called the face value at a specified date, known as the maturity date; and
- a series of equal periodic interest payments called coupon payments.

The basic features of a fixed interest security include:

- Denomination or face value
- Maturity date
- Coupon rate
- Frequency of coupon payments
- Identification of the issuer.

Long-dated securities have terms to maturity ranging from 6 months to 25 years.

3. Dealing

3.1. Methods of Dealing

The main methods of dealing in the Australian long dated securities market are direct via telephone, via brokers or via electronic platforms.

3.2. Electronic Dealing

The increasing sophistication of financial markets has created a space for brokers, dealers and clients to access markets via electronic platforms.

3.3. Business Days

3.3.1. Good Business Day

A good business day is defined as any day on which banks in the state of New South Wales (NSW) are generally open for business, or a day other than one on which banks in NSW are obliged or permitted to close excluding Saturday and Sunday.

Essentially, NSW business days are weekdays (Monday to Friday) other than NSW public holidays as gazetted under the NSW state government’s Banks and Bank Holidays Act 1912.

That said Australian OTC markets generally tend to operate in a reduced capacity on gazetted NSW public holidays that are not similarly gazette in Victoria.

3.3.2. Non Business Day

A non business day is defined as any day on which banks in the state of NSW are generally obliged or permitted to close, including Saturday and Sunday.

In general, AFMA recommends that transactions should not be negotiated for settlement or price fixing (rollover) on a non business day.

Other conventions can be utilised, if agreed upon at the time of dealing by the bilateral parties to the transaction.

3.4. Standard Transaction Size (market parcel)

In the interbank market a standard market parcel is for face value AUD$10million. In EFP transactions, Sydney Futures Exchange (SFE) rules state that there is no minimum number of contracts required.

3.5. Two Way Pricing

Normally, in the professional market bid/offer (two way) markets are given only on the basis of reciprocity. That is, a participant in the professional market can only demand a two way market from a price maker if it is willing to undertake in return to give a two way market in that stock as and when demanded.

3.6. Quotation and Dealing

The market is quoted on a semi-annual yield to maturity basis, not a price basis.

The standard bid/offer spread for securities longer than one year to maturity is the spread dictated by market price makers given prevailing market conditions at that time.

Dealers generally quote on one of three bases:

- *Exchange of Futures for Physicals (EFP)* - Is a service offered by the SFE. In the OTC market each stock trades at a spread to either the three year bond futures contract or the ten year bond futures contract. EFP works by two counterparties striking a deal to trade long term securities and agreeing to swap an agreed number of relevant futures contracts. The number of contracts is a function of the ratio of the PVBP of the stock to the PVBP of the relevant futures contract. Refer to SFE General Bylaws G.7.

- *Outright* - When a dealer deals on an outright basis they quote a yield to maturity at which they are willing to buy or sell the stock. There is no exchange of futures.

- *Switch* - A switch is where a counterparty wants to buy one stock and sell another. This is generally quoted in terms of the difference between the yields to maturity of the two stocks.

3.7. Other Instrument Conventions

3.7.1. 'When Issued' trading in Australian Dollar Government Financing Agencies Tendered Fixed Coupon Bonds

The following entities are Australian commonwealth and state government financing agencies (GFA) for the purpose of these conventions:

- Commonwealth of Australia
- New South Wales Treasury Corporation
- Treasury Corporation of Victoria
- Queensland Treasury Corporation

- Western Australia Treasury Corporation
- South Australian Government Financing Authority
- Tasmanian Public Finance Corporation
- Northern Territory Treasury Corporation

When issued (WI) bonds are those which are priced and awarded in a competitive bid tender process, for example those issued by state GFA at a coupon and maturity combination not currently on issue. Forward trading in such bonds is occurring between the date and time of announcement of a tender and release of tender results.

The conventions provide a standardised basis on which these bonds should be traded and a framework for unwinding such deals in the event that, for whatever reason, the issuer decides to not accept any bids and the tender is cancelled. The conventions provide a formula to determine settlement mechanism for substitute bonds in these circumstances when physical delivery of the WI traded bonds is not possible.

Refer to When Issued Conventions.

3.8. Basis

Not applicable.

3.9. Maturity Conventions

Not applicable.

3.10. Settlement Rate or Index

Not applicable.

3.11. Premium Payment Date(s)

Not applicable.

3.12. Expiry Conventions

Not applicable.

3.13. Broker Conventions

Not applicable.

3.14. Confidentiality

Names of counterparties will not be passed by brokers prior to dealing, unless both parties agree to the passing of their names.

When dealers are trading directly neither party should disclose the name of the counterparty to the transaction dealt or to other market participants.

In support of the ideals of price discovery and market transparency brokers may pass the size of deals dealt and the rate at which they were dealt (post trade) to other broker screen participants only. Brokers will not pass names of counterparties to a deal to other market participants.

3.15. Credit

The ability to deal is subject to credit constraints. Dealers should advise the counterparty if they are unable to deal because of credit limits.

Note that there are many variations in fixed interest trading which result in a combination of standard procedures being applied, such as securing borrowed stock with either cash or substitute stock.

Refer to the Code of Ethics and Code of Conduct (6. Fairness and 6.3. Name rejection citing non availability of credit limits to avoid a deal).

3.16. Exercise of Options

Not applicable.

3.17. Data Source

Pricing information for debt securities can be found on AFMA*data* reference rate page for end of day long term securities.

3.18. Pricing Formulae

Long term securities are traded on a yield basis with the price per $100 face value calculated using the RBA treasury bond pricing formula with the gross price rounded to three decimal places.

Previously (prior to February 18 2002) when transacting with the RBA the gross price was rounded to nine decimal places.

For semi-annual securities that are near maturing (specifically those entitling a purchaser to only the final coupon payment and repayment of principal) the bank bill formula is applied to principal outstanding plus the final coupon.

In the case of securities that do not qualify for the RBA pricing formula, the pricing formula specified by the applicable issuers for primary and secondary market trading will apply.

Disputes over the application of any formula are to be referred to the issuer for arbitration.

1) Basic formula:
$$P = v^{f/d}[g(1 + a_n) + 100v^n]$$

2) Ex-interest securities:
$$P = v^{f/d}[ga_n + 100v^n]$$

3) Near maturity bonds maturing between the record date for the second last coupon and the record date for the final coupon:
$$P = \frac{100 + g}{1+\left(f/_{365}\right)i}$$

4) Near maturity bonds maturing between the record date for the final coupon and the maturity of the bond:
$$P = \frac{100}{1+\left(f/_{365}\right)i}$$

If the maturity date falls on a weekend or other non business day the proceeds date (ie. the next business day) is used in the calculation of *f*.

P = the price per $100 face value

$v = \frac{1}{1+i}$
where $100i$ = the half yearly yield (per cent) to maturity in formulae (1) and (2), or the annual yield (per cent) to maturity in formula (3)

f = the number of days from the date of settlement to the next interest-payment date in formulae (1) and (2) or to the maturity date in formula (3)

d = the number of days in the half year ending on the next interest-payment date

g = the half yearly rate of coupon payment per $100 face value

n = the term in half years from the next interest-payment date to maturity

$a_n = v + v^2 + \cdots + v^n = \frac{1-v^n}{i}$

4. Confirmations

Refer to Australian Dollar Debt Instrument Confirmation & Settlement Standards.

4.1. Timing

All trades entered into must be confirmed either electronically or in writing by both parties on the day that the transaction was executed.

4.2. Obligations of Dealers

Every endeavour should be made for dealers to complete dealing tickets or enter trades into the front office dealing systems in a timely manner to assist back office to generate and deliver confirmations to the transacting party.

4.3. Documentation

Not applicable.

5. Settlements

Refer to Australian Dollar Debt Instrument Confirmation & Settlement Standards.

5.1. Physical Settlements

In general AFMA recommends that transactions should not be negotiated for settlement or price fixing (rollover) on a non business day (see *Section 3.3.2*). Other conventions can be utilised if agreed upon at the time of dealing.

Settlement dates on Australian fixed interest securities are open to negotiation however, the following times are standard:

Type of Security	Settlement
Commonwealth treasury bonds and semi government bonds that are near maturing (as defined in *Section 3.18*).	Same day if dealt before noon, otherwise next business day.
Commonwealth treasury bonds and semi government bonds which are not near maturing.	Trade date plus three business days.
Supernational, corporate bonds and commonwealth inflation bonds.	Trade date plus three business days.

The settlement date is open for negotiation between the parties. Should a non standard settlement apply this fact must be disclosed before negotiating the price.

Ticket Size
Due to liquidity restrictions that sometimes prevail when undertaking settlements ticket size should be limited to AUD$50million, i.e. a deal of AUD$200million commonwealth government bonds should be settled in four lines of AUD$50million.

5.2. Cash Settlements

Not applicable.

5.3. Premium Payments

Not applicable.

5.4. Exercise of Options

Not applicable.

5.5. Settlements Failures

Non Deliverability
The following procedures should be followed in relation to short selling stock:

- If failed settlement occurs the deal will settle on the following business day with no rate adjustment, i.e. at the original agreed settlement price. If settlement continues to fail the settlement price does not alter unless the two parties agree. This is in fact a penalty to the defaulting party as one days interest is accrued to the buyer.

- If a deal has not settled within one hour of the scheduled settlement time (i.e. close of RITS or Austraclear) and the seller believes settlement is unlikely, they should contact the buyer to inform them of this. This will at least provide a warning for the company receiving stock.

- Dealers should be aware if a particular line of stock is in short supply. If the repo rate on a particular line falls this is an indication of illiquidity and dealers should ensure that they have stock available for future settlements. Dealers should not sell stock if they believe that they cannot deliver that stock at settlement.