AFMA

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Domestic Markets and Risk and Compliance Departments
Reserve Bank of Australia
Martin Place
Sydney NSW

By email: eligible_securities@rba.gov.au

Dear RBA Team

BBSW Fallbacks in RBA-Eligible Securities

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the Reserve Bank of Australia's (Bank) plan to publish new eligibility criteria in the first half of 2021 which will require fallbacks for new BBSW-linked securities issued on or after 1 July 2022. The Bank is seeking to understand whether there are any issues it should be aware of, and how the timing of the development of fallbacks for BBSW-linked securities aligns with other work to strengthen financial benchmarks.

AFMA in consultation with its members has reviewed the draft criteria the Bank has proposed for fallback provisions to meet and considered the questions posed by the Bank. AFMA is in general support for the Bank's planned course.

AFMA's IBOR Market Responses Working Group in February considered developments associated with the IBOR transition, including the Bank's proposed course of action on fallbacks for eligible securities, and recommended that the ISDA methodology for fallbacks be adopted for Floating Rate Notes (FRN). An AFMA legal group has been formed to consider appropriate template language for FRNs issued in the Australian market based on this recommendation. The legal work is taking account of the Bank's draft criteria in its deliberations. AFMA is socialising its recommended approach to FRN fallback language with other industry groups and is looking to develop a market consensus. Overall, it is considered that steady progress has been made since the start of the year in providing the documentation basis for the adoption of market accepted language on fallbacks consistent with the international developments.

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Questions

1. *Are there any technical, practical or legal issues that would prevent industry developing fallbacks that meet these criteria?*

   We do not consider there are any material issues that prevent the development of fallbacks. Work is well underway to develop documentation language and processes to meet this need. There is more work to do as decisions, actions and processes need to be put in place to give effect to the development of fallbacks. None of these points are considered to be an insurmountable obstacle.

   FRNs referencing BBSW, regardless of date of issuance, will need alternative rate fallback language for market acceptance, and those without may be avoided by investors, impacting their liquidity. As a practical matter the fallback language will be aligned with the ISDA fallback language for derivatives contracts set out in their Supplement which came into effect on 25 January 2021. There are legal drafting issues associated with cross-referencing a methodology set out in another document but there is confidence that these matters can be addressed.

2. *Do these criteria provide sufficient flexibility for industry participants to develop fallback language that meets the requirements of each relevant market?*

   The criteria as presented are considered to sufficiently flexible and a helpful guide to the market. For FRNs the requirement to have at minimum one 'robust' and 'reasonable and fair' fallback is not onerous, given that the use of AONIA compounded in arrears is already generally socialised and accepted as the fallback methodology based on the model provided by the ISDA Supplement given effect by the Protocol which came into effect on 25 January 2021.

3. *Assuming the Bank publishes the final criteria in the first half of 2021, is there sufficient time for industry participants to develop and implement fallback language for the criteria to come into effect on 1 July 2022? How does this align with current workstreams underway, such as the LIBOR transition and the development of industry standards for products that reference AONIA?*

   AFMA has been advised that the 1 July 2022 timeframe may present operational challenges. While major financial institutions are well advanced in their preparations there continue to be concerns with the readiness of smaller institutions with more limited resourcing, which is stretched across a number of regulatory projects at present. Adoption of market standard fallback language is not the impediment. Challenges lie in operationalising the change in both the issuer's and the investor's systems. There is a need to adjust valuation and accounting systems to accommodate the potential change. Based on the experience with the APRA regulatory reporting change timetables, system change schedules take at least two years to implement from the date a formal regulatory requirement is set in place.

More generally, it is expected that the market will give issuers no choice but to insert fallback language in all BBSW referencing securities if they want to avoid a lack of demand and pricing bifurcation for their securities.

As mentioned above, AFMA has in place a work group to develop fallback language for FRNs.

4. *Are there any other issues related to fallbacks for BBSW-linked securities that the Bank should be aware of?*

   There are broader implications with market acceptability for securities which do not meet the eligibility requirement. For example, what might APRA's view be on fallback deficient securities being allowed in the liquidity portfolio of entities it regulates?

   The market more broadly might bifurcate and discriminate against fallback deficient securities being held in portfolios.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

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