# DEBT TRADING GUIDELINES

Australian Financial Markets Association

www.afma.com.au

# Debt Trading Guidelines

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## Australian Financial Markets Association

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# 1. WHAT THESE GUIDELINES ARE ABOUT

The smooth and efficient functioning of debt instrument markets rely on the integrity, honesty, good faith, and mutual trust shown by all participants. An efficient market fosters liquidity, which helps all participants including Australian Financial Markets Association (AFMA) members transfer their risk through a market transaction more effectively.

1) It is important that both buyers and sellers promote market liquidity. Among other reasons, market liquidity allows benchmark rates to be determined. For example, the AFMA Bank Bill Swap BBSW benchmark rate plays a prominent role in Australia's financial infrastructure. It finds extensive application in both lending transactions and interest rate derivative products and is critical for the sound operation and stability of Australia's financial markets. AFMA committees manage conventions for trading in money market instruments underlying benchmark rates, principally Bank Accepted Bills (BABs) and Negotiable Certificates of Deposit (NCDs) for BBSW.

2) These Guidelines are supplemental to the AFMA Code of Conduct and should be read in conjunction with this code.

# 2. COVERAGE

These Guidelines have general application to trading participants in the Australian debt market. They relate to all debt instruments of any tenor that create the obligation for the issuer to pay a fixed sum called the face value at a specified date; and may also involve a series of periodic interest payments, or coupons (Debt Instruments).

# 3. SUPPORTING THE MARKET

## 3.1. Liquidity

Trading participants should behave in a manner that is consistent with supporting market liquidity. Examples of behaviours that hinder liquidity include those that cause or exacerbate settlement fails, those that inhibit the provision of liquidity by others, and those that restrict the floating supply of a particular issue in order to generate price movements in a Debt Instrument or related markets.

## 3.2. Issuance Volume

Trading participants should bear in mind that sudden changes in the volume of issuance of Debt Instruments by their organisation may disrupt the marketplace. Trading participants should evaluate how their issuance of Debt Instruments may affect market liquidity under different market scenarios, having regard to the market's normal liquidity and capacity to facilitate issuance or purchases of significant sizes, and conduct activities in a manner which is minimally disruptive wherever possible.

### 3.3. Quoting Prices

Where possible trading participants should quote prices in accordance with the quotation methodology and market parcel size described in the relevant AFMA Conventions, with the goal of promoting price transparency and liquidity for all trading participants.

### 3.4. Price Discovery

Legitimate price discovery activities are an integral part of the Debt Instruments markets and should be encouraged.

Trading participants should follow pricing practices that support transparent and actively traded markets. For example, BBSW relies on market data consisting of executable bids and offers from transparent and actively traded markets. Transparency means that traders provide market pricing that more accurately reflects the equilibrium value of prime bank paper.

Price discovery relies on efficient price reporting and transparent markets. Trading participants should support transparency. For example, to promote transparency AFMA publishes transactional volumes underpinning benchmark rates on a one-month delayed basis.

## 4. OVERSIGHT OF TRADING ACTIVITY

Trading participants should ensure adequate internal oversight of their trading activity in Debt Instruments. The level of oversight may vary depending on the nature, scale and complexity of each firm's business. However, all firms should develop policies and procedures for measuring and scrutinising their overall trading activity in Debt Instruments to ensure that trading behaviour in the aggregate, as well as along individual business lines, is understood by senior business managers.

## 5. MANAGING CONFLICTS OF INTEREST POLICY

Trading participants should have a documented policy relevant to their trading procedures which identifies and provides for managing conflicts of interest. Records of conflict of interest situations should be kept and any advice that may be given in this regard. Records are to be kept in a readily accessible format, and retained for the minimum statutory period.

## 6. OVERSIGHT CONTROL

### 6.1. Control Environment

Trading participants that are active in financial markets are familiar with the importance of establishing and maintaining a rigorous internal control environment. The variety of regulatory and reputational pressures that a firm's trading and settlement operations are subject to indicates that a vigorous, well-informed, and assertive internal control program is essential.

An internal control program should include the active engagement all stakeholders including but not limited to the business: audit; legal; market risk; operations; and compliance functions. The purpose of this is to ensure that its Debt Instruments business acts in accordance with relevant legislation and best market practices including appropriate information barriers known as Chinese Walls between, for example, trading and loan origination functions.

Additionally, trading desk management and those involved in the oversight of transactions should implement policies and procedures, such as monitoring risk limits, to ensure that any questionable trading practices are identified and addressed in a timely manner. To this end, trading desk management and supervisory staff should be aware of, and understand strategies executed by the trading desk.

Those staff employed in a risk function should have a background that allows them to detect any potential problems including fully understanding the complete front-to-back process and any product features of that area of the firm's business which they oversee. Similarly, risk staff should have a thorough understanding of the objectives and trading strategies being employed either as principal or on behalf of clients to detect potentially questionable activities.

Other control functions, and particularly legal and compliance staff, should be empowered to evaluate and respond promptly to questionable trading practices should they occur. Trading participants should aim to provide real-time trade position information to the oversight function in order to provide timely notification of problematic positions.

Senior business managers should take responsibility for ensuring that internal control policies are fully implemented and followed in their business areas.

## 6.2. Review of Trading

Individuals responsible for oversight functions, and particularly legal and compliance staff, should be empowered to bring any concerns to the attention of appropriate senior business managers within the organisation. Individuals responsible for internal control functions that track capital charges associated with trading activity, including settlement fails, should communicate these charges and their source to senior and trading desk management.

Internal control policies should identify the specific trading trends, positions, strategies, or behaviours within the trading operation that constitute triggers for mandatory business and compliance review. Mandatory review does not in itself automatically suggest that a trading position, strategy, or behaviour must be altered; that will depend on the results of the review and consultations between management and compliance. Because the structure of the Debt Instrument markets is always evolving, triggers for mandatory review (and the appropriate thresholds for individual triggers) may change over time as the size and structure of the market change and as a member's business evolves.

# 7. LARGE POSITIONS

## 7.1. Managing Responsibly

Overall, trading participants should be mindful of the potential market impact of their activities in the market, particularly with regard to large positions. Although large long or short positions are not necessarily problematic, these positions should be managed responsibly to avoid market disruptions. A market participant should manage any large position with heightened vigilance, mindful of the need to encourage efficient, honest and fair markets. When evaluating trading strategies for large positions, trading participants should take care that changes to their normal participation in the markets does not adversely affect the liquidity or settlement of the Debt Instruments in the marketplace.

## 7.2. Internal Alerts

Trading participants should have policies and procedures in place to ensure timely escalation to both management and oversight of unusually large positions—long and short—taken by a trading desk.

# 8. TIMELINESS

Trades should be entered into trading systems promptly by the trading desk staff and made available to the operations area as quickly as possible.

Relevant transaction information should be provided to counterparties well in advance of applicable cut-off times so that counterparties can make timely delivery of securities.

# 9. SEPARATION OF TRADING FROM OPERATIONS

Front office traders and dealers should not in any way take part in the processing or settlement of transactions. Trading participants should take particular care to ensure that front office representatives do not have the ability to modify cash flows relating to transactions.

Middle office and operations staff are to have separate reporting lines to management, with roles and responsibilities clearly defined. Under no circumstances should front office staff have managerial responsibility for middle office or operations staff.

Settlement staff should be empowered to question instructions from trading staff by elevating unusual instructions to the attention of management. In addition, policies should require that all requests that deviate from normal settlement practice be escalated to relevant oversight staff in a timely fashion.

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