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Long Term Government Debt Securities Conventions

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Preface: AFMA Code of Conduct

AFMA promotes efficiency, integrity and professionalism in Australia's financial markets. The aim of the AFMA Code of Conduct (the Code) is to establish a common understanding of the standard of behaviour expected of all AFMA Member organisations and their employees when conducting business with clients, counterparties and colleagues and when providing financial services to retail and wholesale clients.

All AFMA Financial Markets Members and Partner Members[1] are expected to observe the Code and operate with integrity, professionalism and competence. The Code is designed to support behaviours that put the interests of clients, the firm and the wider community ahead of personal or individual interests and promotes confident participation by users in Australia's OTC markets.

Market participants are reminded that they are generally expected to observe and adhere to the market standards and conventions[1] as set out below when engaging in any form of market dealing.

1. Description

Long Term Government Debt Securities

Long term government debt securities are debt instruments issued by the Australian Commonwealth and State Government Financing Agencies. They create an obligation for the issuer to pay a series of periodic interest payments at regular intervals and return the face value to the holder at maturity. These payments can be either set at a fixed rate of floating rate. Long-dated government debt securities have terms to maturity ranging from 6 months to 25 years.

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
- ACT Treasury

Long term government debt securities are the primary mechanism for the Commonwealth, State Governments and Territories of Australia to meet their long-term funding requirements.

The following Long Term Government Debt Securities Conventions cover the two primary fixed income products issued by these authorities. These are Fixed Rate Bonds and Floating Rate Notes.

These Conventions reflect current market practices and are maintained by the AFMA Debt Securities Committee.

[1] As defined in the AFMA Constitution

2. Products

2.1. Fixed Rate Bonds

Fixed Rate Bonds
A Fixed Rate Bond is a debt instrument which pays a fixed rate of interest (coupon) at specified dates over the term of the debt, as well as repaying the principal on the maturity date. Typically, the interest is paid semi-annually.

2.2. Floating Rate Notes

Floating Rate Notes
A Floating Rate Note is a debt instrument which pays a variable rate of interest (coupon) at specified dates over the term of the debt, as well as repaying the principal on the maturity date. The floating rate is usually a money market reference rate, such as BBSW, plus a fixed margin. Typically, the interest is paid quarterly.

3. Dealing

3.1. Methods of Dealing

All Products
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

All Products
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

All Products
Business Day: A Business Day is defined as any day which is not a 'bank close day' under the law of New South Wales. Further information can be found on the AFMA website. **Market Trading Hours:** Market trading hours are 8.30am to 4.30pm in Sydney on all Business Days however market participants may use their discretion when quoting clients or offshore counterparties outside of these hours.

3.4. Customary Transaction Size

All Products
No specific convention.

3.5. Two Way Pricing

All Products
No specific convention.

3.6. Quotation and Dealing

Fixed Rate Bonds
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 ASX 24 Operating Rules Procedures 4800. • *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.
Floating Rate Notes
The market is quoted on a trading margin basis, usually as a margin above BBSW.

3.7. Basis

All Products
Not applicable.

3.8. Maturity Conventions

All Products
Not applicable.

3.9. Settlement Rate or Index

All Products
Not applicable.

3.10. Premium Payment Date(s)

All Products
Not applicable.

3.11. Expiry Conventions

All Products
Not applicable.

3.12. Broker Conventions

All Products
Not applicable.

3.13. Confidentiality

All Products
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.

3.14. Credit

All Products
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).

3.15. Exercise of Options

All Products
Not applicable.

3.16. Data Source

All Products
Not applicable.

3.17. Pricing Formulae

Fixed Rate Bonds
Fixed Rate Bonds are traded on a yield basis with the price per $100 face value calculated using the AOFM treasury bond pricing formula with the gross price rounded to three 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 AOFM 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: $P = \frac{100+g}{1+(f/365)i}$ 4) Near maturity bonds maturing between the record date for the final coupon and the maturity of the bond: $P = \frac{100}{1+(f/365)i}$ If the maturity date falls on a weekend or other non business day the proceeds date (i.e. the next business day) is used in the calculation of *f*. *P* = the price per $100 face value $v = \frac{1}{1+i}$ where 100*i* = 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

$a_n = v + v^2 + \cdots + v^n = \frac{1-v^n}{i} \;\; except\ if\ i = 0\ then\ a_n = n$

Floating Rate Notes

$$P = \frac{Z(b + IM) \times \frac{d}{365} + \left(\frac{IM - TM}{k}\right) A_n^i + 1}{1 + (r + TM) \times \frac{f}{365}} \times 100$$

P = price per $100 per face value

Z = 1 if there is an annuity payment to the purchaser at the next annuity payment date, 0 if there is no payment to the purchaser at the next annuity payment date

b = the floating benchmark rate from last interest reset date to next interest rate date

d = number of days in current interest period

IM = interest margin (as a percentage) paid in addition or deduction from the floating benchmark

TM = trading margin (as a percentage) paid in addition to the floating benchmark

r = the floating benchmark rate to the next interest rate reset date

f = number of days from pricing/settlement to next interest payment date

$A_n^i = \frac{1 - (1 + i)^{-n}}{i}$

$i = \frac{s + TM}{k}$

If *i = 0,* then $A_n^i = n$

k = payment frequency of FRN (e.g. 2 = semi-annual, 4 = quarterly)

s = yield from settlement to the maturity of the FRN (with frequency *k*)

n = number of complete interest periods to maturity as at the next interest payment date

Market participants are under no obligation to use the benchmark rates referred to above if the market has moved since the benchmarks were set.

When the floating reference rate being used is the BBSW rate, *b* and *r* should be the average figure quoted BBSW rounded to two decimal places. *s* should be the swap rate negotiated by the counterparties entering into the transaction, ensuring rates used are of similar frequency (or converted) to the FRN, then straight line interpolated to the maturity date, if necessary, then rounded to two decimal places. The FRN price should be calculated to three decimal places.

Interpolation

- Dates for BBSW are based on the modified following business day basis.
- Actual next interest payment date and maturity date are used.
- When interpolating *r*, BBSW is supplemented by the RBA target cash rate (RBA30) with a date of the next business day.
- Swap rates 4 years and over need to be converted from semi-annual fixed rates versus 6 month BBSW to quarterly fixed rates versus 3 month BBSW (assuming quarterly frequency on FRN).
- When interpolating *s*, swap rates are supplemented by the 1 to 6 month BBSW rates and the RBA target cash rate.
- Linear interpolation is used unless otherwise stated and agreed.

Floating Rate Securities with negative interest rates but with a zero rate floor coupon

Where the swap rate is less than the negative of the interest margin and there are no positive coupons at or beyond the next coupon date but there is a zero floor on the coupons, the following AFMA floating rate note convention formula should be used:

$$P = \frac{Z(b + IM)^{+} \times \frac{d}{365} + (1 + i)^{-n}}{1 + (r + TM) \times \frac{f}{365}} \times 100$$

Where:

$Z(b + IM)^{+} = max\ \{Z\ (b + IM), 0\}$

3.18. Other Dealing Conventions

4. Confirmation

4.1. Timing

All Products
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

All Products
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

All Products
Not applicable.

4.4. Other Confirmation Conventions

All Products
Not applicable.

5. Settlement

5.1. Physical Settlements

All Products

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 3.17*).	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 two 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

All Products

Not applicable.

5.3. Other Settlements Conventions

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 day's 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.