

3rd December 2015

Council of Financial Regulators
BBSW Consultation
GPO Box 3947
Sydney NSW 2001
Australia
Submission by email: BBSWConsultation@rba.gov.au

Dear Sir/Madam,

Re Evolution of the BBSW Methodology – Consultation 2015

Finance and Treasury Association (FTA) is pleased to provide our comments to the Council of Financial Regulators' (The Council) BBSW Consultation, with a particular focus on the concerns of our members working in senior treasury and finance roles in Australian-resident non-financial-sector corporations.

FTA supports the objective of the consultation process to ensure BBSW remains a trusted, reliable and robust benchmark, given the emergence of more difficult financial market conditions over recent years.

The Council has raised issues and concerns throughout its "Evolution of the BBSW Methodology Paper" which are highly relevant to our members. FTA's Technical Committee of corporate treasurers supported by bankers, senior accountants and lawyers has considered the Council's Consultation Paper on BBSW and provided advice to our CEO for this submission.

Overall Comments

FTA has a significant interest in interest rate benchmarks because they are the key to efficient and fair allocation of capital within financial markets.

For corporate treasurers in particular, as the central financial market participants on behalf of non-financial corporations, benchmarks are vitally important because they are used for pricing derivatives which are vital for risk management. Benchmarks such as BBSW are used to price most interest rate products that banks provide to companies and referenced in much long-standing market documentation.

Based on a 2013 survey of FTA member corporate treasurers, the most important characteristics of a reference rate for Australian corporations in rank order are:

1. Reliability (proper safeguards against manipulation or error);
2. Robustness (including in times of market stress);
3. Frequency (e.g. to facilitate daily rate-sets);
4. Readily available;
5. Broad acceptance; and
6. Representativeness (e.g. of a specific risk type).

FTA notes this list is consistent with the list from the March 2013 Bank for International Settlements Economic working group paper "*Towards better reference rate practices: a central bank perspective*" with the additional element of "broad

acceptance” which perhaps goes without saying is a pre-requisite for an industry benchmark. Nonetheless, it is relevant to the discussion of the Council’s four Options for the future BBSW methodology as “broad acceptance” comes from familiarity and indeed comparability over time, hence FTA sees it as desirable that an improved benchmark retain similar qualities to that it displaces.

In particular, FTA cautions about any changes that may result in a change of basis or changes which might undermine the consistency and continuity of BBSW. With BBSW enshrined as the benchmark in the documentation of many financial institutions and corporations any new methodology that causes changes in performance e.g. volatility and credit risk characteristics may see market disruption at least in transition.

FTA would expect the Council to consider all six of the key characteristics of a benchmark reference rate as it determines the relative benefits of options presented for consideration in the Consultation Paper.

In reality, as discussed in AFMA’s Benchmarks committee deliberations on these matters there are few if any interest rate markets from which a benchmark rate could be drawn that would completely satisfy all of the attributes identified by BIS. An ideal market in this context would have multiple buyers and sellers, each of similar market power with continuous pricing of standard market parcels at low spreads, transparency, good regulation and trading that is resilient during time of stress.

Further, there is a range of practical matters that must be factored into the evaluation process. This should include ease of implementation, the degree of market participant support, steps that might be required to ensure continuity of a benchmark and the extent to which the benchmark process might expose market participants to regulatory risk.

BBSW continues largely to meet the criteria of corporate treasurers and financial officers although we take on board the comments to the Bloomberg conference on November 18th by Reserve Bank Assistant Governor Dr Guy Debelle where he questioned BBSW’s role as a default and suggested users of BBSW need to review whether it is the most appropriate benchmark in all cases.

FTA observes that notwithstanding changes by AFMA to the BBSW calculation in consultation with regulators in September 2013 that further changes are likely to be needed as a result of Financial Stability Board (FSB) recommendations and on-going changes in market practice. In particular, as the Council itself observes on page 3 of its document, market practice has been for inter-bank trading to shift away from the period of the rate set notwithstanding the wider window introduced in 2013.

While supportive of measures to strengthen trust in the benchmark, FTA suggests ASIC investigative action around alleged manipulation of BBSW, while in principle has made it more reliable, may have had an unintended consequence of drawing liquidity away from the trading window and so potentially undermined the robustness of the benchmark. (Anecdotally, banks are becoming reluctant to put up prices which may be perceived in any way to be divergent. As relatively sophisticated buy-side clients of banks, FTA members are aware of a range of bank regulation and market factors that mean that even banks with identical credit ratings have differential cost of funding.)

This observable reluctance from banks to provide pricing, despite the wider collection window and to be part a process requiring expert judgement, in our view effectively rules out the status quo of Option 1 as a long term solution.

Considering the Options

With regard to each of the options a learning from the current environment is that behaviours will change depending on the option chosen. Arguably each of the options in the Consultation Paper presents its own challenges that are not fully explored or developed in the consultation document. Hence ideally there should be more time for industry-awareness raising and feedback sessions involving not only Prime Banks and other sell-side firms but also the buy-side and end users.

We agree it is desirable to clearly anchor the BBSW benchmark to observable transactions entered into at arm’s length between buyers and sellers in the market.

And FTA considers widening of the calculation method to a broader set of NCD market will improve the liquidity in setting the BBSW rates and may further reduce opportunities of those rates being manipulated. Further widening the rate collection window and adding investment manager trades to the interbank market should assist liquidity.

Hence if the Council considers it imperative that a new methodology be adopted expeditiously, FTA's preferred option is in principle, for the evolution of the BBSW methodology to "Option 2: Anchor NBBO calculation methodology to a broader set of NCD market transactions".

FTA recognises that it would be necessary for Prime Banks to "directly negotiate the interest rates on Prime Bank NCDs with third parties", rather than linking the rate to BBSW. Those third parties are of course buy-side participants including asset managers and corporate treasurers.

We note the Council's explanation that "To ensure transparency of market activity, each Prime Bank would be required to submit daily data to the administrator on their NCD transactions. ... consistent with existing reporting arrangements, as Prime Banks are already required under the *AFMA Prime Bank Conventions* to disclose their trading volumes in Prime Bank NCDs and BABs on all trading days."

FTA is supportive of AFMA continuing in its current roles with regard to BBSW. (Disclosure: FTA's CEO David Michell is currently a member of AFMA's Benchmarks committee which oversees benchmark methodology to promote reliable and effective financial benchmarks.)

Finally, FTA observes that it may be necessary for the Council of Financial Regulators to mandate Australia's four Prime Banks to change market practice around pricing NCDs independent of BBSW, and to report as required in Option 2 for an enhanced BBSW benchmark. In so doing it should also indemnify buy-side participants to these transactions. FTA suggests that in the interest of the reliability and robustness of such critical infrastructure these actions be seriously considered.

Conclusion

FTA welcomes the opportunity to participate in this important consultation on behalf of its member corporate treasurers and affiliated professionals.

BBSW continues largely to meet the objectives of corporate treasurers and financial officers however FTA observes that notwithstanding changes to the BBSW calculation in September 2013 that further changes are likely to be needed as a result of global financial regulations and on-going changes in market practice.

FTA supports the evolution of the BBSW methodology to a broader set of NCD market transactions as in Option 2. However, we consider there should be more time for industry-awareness raising and feedback sessions involving not only Prime Banks and other sell-side firms but also the buy-side participants like treasurers.

We suggest whichever option is chosen the Council consider mandating Prime Bank participation as this will FTA expects remove current obstacles, and be privately welcomed by the banks themselves. Finally, the Council should indemnify buy-side participants to these transactions to avoid any perception of regulatory risk.

Yours sincerely,



Michael Christensen FFTP
President
Finance and Treasury Association



David Michell CFTP (Snr)
CEO
Finance and Treasury Association

About FTA

*The Finance and Treasury Association engages in Advocacy activities on behalf its members and the broader treasury and finance profession in order **to inform policy, regulation and market operations that impact on the corporate treasury function and more generally the Australian financial markets.** Furthermore, FTA's Advocacy activities are intended to raise the profile of treasury functions in non-financial and public sector organisations and the community at large as it is considered that treasury and financial risk professionals have a unique and valuable perspective.*

FTA's more senior members tend to be corporate treasurers. They are the natural counterparts externally to banks and investment banks, and to specialist risk, legal, tax and accounting advisors. (And with their CFOs they have a primary responsibility for interaction with debt investors and ratings agencies.)

And due to their core centralised cash management function, corporate treasurers interact with a range of internal stakeholders i.e. most of their company's key business units. As the corporate finance professionals who are the in-house corporate finance experts, corporate treasurers are trusted to make decisions about sources of capital; for instance, internally they are the key drivers of corporate bond issuance.

With this responsibility for both liquidity and funding, treasurers are required to implement strategies to ensure solvency and to protect corporate balance sheets. A key activity of most sophisticated treasuries is thus hedging of interest rate and exchange rates, and commodity price inputs and outputs. Key tools used by treasurers are exchange-traded and over-the-counter derivatives. Corporate treasurers are primary end-users of financial services.

Corporate treasurers have corporate governance responsibilities and must operate within board-approved policies. Most corporate treasurers have reporting lines into Board committees, the Chief Executives and Chief Financial Officers.

Ultimately, finance and treasury professionals are key custodians of corporate value and reputation. As such FTA considers that corporate treasurers have a vital and differentiated perspective to provide to policy-makers, regulators, service providers and other financial market participants.

FTA seeks to elevate the understanding of treasury activities and responsibilities among external and internal stakeholders and to provide an authoritative voice on all matters that relate to the practice of corporate treasury and financial risk management.

FTA develops its advocacy positions independently of its own commercial considerations.

In its advocacy activities FTA takes the standpoint of non-financial-sector corporations although as a skill-set based body, FTA's membership includes members whose professional role is to provide services to non-financial-sector corporations. FTA works with like-minded Associations on matters of common interest and to share resources.

FTA will respond to formal and informal consultations from governments and regulator as well other associations which set or oversee market practices in the following areas:

- Role of non-financial corporations as end users of financial products/services/markets
- Corporate financial policy and financial management
- Risk management
- Banking and payment systems
- Tax
- Relevant accounting and other disclosure practices and standards
- Corporate governance