BBSW Benchmark Design

Our Interpretation of the Principal Objective:

To improve the level of trust in the methodology and function of deriving Australia's notional risk free rate.

Curve Securities recognises the importance of Australia having a robust interest rate benchmark underpinned by a credible rate setting mechanism. Curve Securities feels qualified to make this submission given our experience in wholesale foreign exchange dating back to pre-float 1983 and money market/fixed income since February 1985.

Peter Sheahan, Director – Institutional Markets was a member and Chairman of the AFMA Long Term Securities Committee 1996 – 2001. During this time the committee accomplished the transition for settlement of fixed income securities from T+5 to T+3. Also in the period of emerging digital exchanges around 2000, the committee evaluated the transition of OTC fixed income market to an on exchange platform. These discussions were a catalyst for a small group of banks to undertake the embryonic development of Yieldbroker.

Peter also assisted Ken Farrow, CEO of AFMA in the technology architecture and functional specification of AFMAdata. Discussions during 2000 - 2001 saw AFMA commission similar databases and browser based search tools already supporting the nab Global Wholesale Financial Services intranet and www.nabmarkets.com.au platforms. This permitted AFMA to create a new revenue stream from the broad distribution of Australia's interest rate benchmark sourced from its closed membership.

Previous employers include CBA & NAB.

Curve Securities Market Function

Curve Securities Pty Ltd is an independent fixed income intermediary focused on servicing the interest rate investment needs of a diverse group of wholesale clients.

History of Curve Securities

Curve Securities was established in 2009 and has grown to service over $4.3 billion in current deposits and has placed over $28.0 billion in deposits with a wide range of banking institutions since inception. Current turnover is $1.0 billion per month.

With over 150 years of collective financial markets experience Curve Securities brings together a small but highly experienced team with the desire and ability to assist a diverse range of clients.
Client Breakdown

Curve Securities clients include institutional fund managers, federal, state and local government agencies, private and public companies, unions, health funds, religious groups, charities, SMSF and authorised deposit-taking institutions throughout Australia.

Consideration has been given to the 4 options proposed in Section 4 of the Consultation Paper. Curve Securities has formulated our submission on a strong preference for the establishment of a framework commensurate with Option 2.

Questions and Answers:

Q1. The market underlying the BBSW benchmark is currently the interbank market at the time of the rate set. Should the definition of the underlying market be broadened to include all funding transactions with wholesale counterparties, such as pension funds, and non-financial corporations?

A1. Curve Securities favours increasing the contributory sample by inviting the buy-side client segment to nominate qualifying NCD, BAB & Term Deposit transactions over a formal sample collection period.

The Council of Financial Regulators could oversee the accreditation of nominations by the existing Prime Bank and other ADIs for Qualifying Asset Manager (QAM) status or receive applications direct from prospective contributors.

3 potential categories of QAM are as follows:

1. Prime Investors (NCD/BAB)
2. Prime Investors (Term Deposit)
3. Prime Investors (NCD/BAB & Term Deposit)

The Centre for Financial Regulation (CFR) could reasonably expect the sample of Qualifying Asset Manager's negotiated transactions to significantly increase if invitations were extended to the following eligible contributors:

- ADIs beyond the 4 Major Banks
- Central Borrowing Authorities
- Federal & State Owned Corporations
- Institutional Fund Managers
- Industry Super Funds
- Local Councils
- Religious, Health & Not for Profit Organisations
- Non-Financial Corporations

It is our opinion a reasonable number of qualifying participants would welcome a potential new level of pricing power as a price-influencer from the existing "modus operandi" of essentially being a post BBSW price-taker.

Under a no obligation methodology with limited regulatory compulsion, individual decisions to position any transaction as an included or excluded transaction would be a bi-lateral negotiated undertaking with merit of the offered price underlying the end decision.

Qualifying Asset Managers would be faced with a number of new cash flow management considerations. The dynamics of supply and demand and optimal market timing would intensify for Prime Investors as price influencers. Benchmarks are critical in the final cost of a wide array of interest rate risk management products. There may be reasonable opportunities within the negotiation process to skilfully optimise earnings or achieve higher level of certainty on key risk metrics. It will be interesting to observe how participants adjust their execution strategies.

Q2. Should the eligible securities for calculating BBSW be broadened beyond BABs and NCDs to include other financial products such as term deposits that reflect the cost of the Prime Banks' total wholesale fund raising at the relevant maturities?

A2. This question seeks to determine a simple list of qualifying products; however, careful analysis of the non-standardised pricing elements is critical. The range of pricing offered for this narrow set of products is not homogeneous for all the Qualifying Asset Managers nominated in Q1.

The broad range of Qualifying Asset Managers undertakes investment transactions across a wide spectrum of ADI liability pricing. The cost of holding higher levels of liquidity implicit in Prudential Standard APS 210 to meet differing cash outflow categories across the client spectrum has created as many as 5-6 tiers of pricing by ADIs not all of which can be directly tied to external credit ratings as explained in the following paragraphs.

ADIs have a wide difference in the products and pricing they offer each category of potential contributors. There are examples where an Institutional Fund Manager is restricted to investing in only NCD/BABs and is not offered Term Deposits. The normal additional yield attributed to the less liquid Term Deposit is unavailable and is largely a Hobson's choice by ADIs who limit product availability or offer unrewarding yield pickup as a disincentive.

Institutional Fund Managers find some banks are willing to offer a ratio of NCD/BAB & Term Deposits to help maximise earnings on their distinction between liquid and core portfolio holdings where restricted availability is assumed.

Prudential Standard APS 210 implemented on 1 January 2015 has incorporated a framework using 8 levels of Run-off rate percentages. Hence, pricing for NCD/BAB & Term Deposits is not standardised across all ADIs. Internal models categorise clients using industry standardised classification codes. Furthermore, ADIs constraints to achieve matched funding and fine-tune product and segment pricing to manage supply/demand dynamics means the level of complexity to distil the right subset of transactions is elevated.

Qualifying Asset Manager	**APS 210 Pricing Category**	**Run-off Rate %**
ADIs beyond the 4 Major Banks	Financial Institution	100%
Central Borrowing Authorities	Financial Institution	100%
Federal & State Owned Corporations	Middle Market	40%
Institutional Fund Managers	Financial Institution	100%
Industry Super Funds	Financial Institution	100%
Non-Financial Corporations	Middle Market	40%
Local Councils	Middle Market	40%
Religious, Health & Not for Profit Organisations	Middle Market	40%

Non-Financial Corporations achieve concessional Term Deposit pricing due to their large term loan or bank bill lending exposures. This is most evident for clients who are not offered off set facilities to maximise earnings on their liquidity management.

In our continuously evolving global markets, participants are improving their capabilities in managing to an illiquid environment. A reduction in the perceived immediacy of risk transference, a transition toward more buy and hold strategies in credit markets and the evolution of managing liquidity risks via breakable and unbreakable TDs are just some examples of recent changes to market practices and behaviours.

Q3. What should be the minimum size for wholesale funding transactions to be in scope for BBSW?

A3. We recommend the minimum size for NCD/BAB and Term Deposits transactions be set at =>$5m.

Q4. Should offshore Australian dollar denominated wholesale funding transactions be included, or only transactions undertaken in Australia?

A4. Curve Securities does not have a sufficient current and historical perspective of the client demographics, price tiering, competitive price discovery dynamics and potential sample base of offshore Australian dollar denominated wholesale funding transactions to comment. And in any case we would see BBSW as targeted at domestic based activity.

Q5. If the NBBO method were not to be used, what should be the fall-back mechanism for Prime Banks and the administrator in the event that there are insufficient transactions for calculating BBSW?

A5. The primary objective is to gain the most realistic sample size of actual transactions in the market by Prime Banks and Qualifying Asset Managers.

Reverting to NBBO lacks integrity as it reverts to a simplistic declaration by the panel of Prime Banks of nominated rates and disregards the contributions of the newly accredited Qualifying Asset Managers.

Curve Securities proposes a suggestion to revert to calculating the benchmark as a 1 day lag of all NCD/BAB and Term Deposit transactions =>$5m (or value set by Q3.) undertaken between Prime Banks and Qualifying Asset Managers during the previous day across both the new pre rate set transaction window and post rate set transaction period prior to close of business.

Q6. Should the set of Prime Banks be larger than the four major banks, and how could the existing criteria for Prime Banks be amended to achieve this?

A6. AFMA's BBSW Committee has long debated the merits of a narrow or broader array of ADI contributors.

All asset class benchmarks are constructed to reflect a narrow or comprehensive dataset. Asset managers in conjunction with consulting actuaries evaluate a wide spectrum of indices to choose the best-fit benchmark to accurately assess relative performance.

Curve Securities proposes recognising the Risk, Return, Diversification and Liquidity decisions of Qualifying Asset Managers to arrive at an answer to the question of "Who are the appropriate ADIs to reference qualifying wholesale funding deals for calculation of our interest rate benchmark?"

Curve Securities recommends taking a progressive step to recognise NCD/BAB and Term Deposit transactions =>$5m with a qualifying set of ADIs undertaken during the sample collection period.

The inclusion of these transactions negotiated within the sample collection period could be liquidity and credit risk weighted in the rate set algorithm to contribute to an enhanced and deeper risk free rate benchmark.

In our continuously evolving global markets, participants are improving their capabilities in managing to an illiquid environment. The GFC was a catalyst for some Qualifying Asset Managers to move beyond investing in credit wrapped securitised RMBS assets of a broader array of ADIs to directly supporting ADI balance sheets via tradeable short-term securities and deposits.

All Qualifying Asset Managers regularly review their credit risk decisions and act on relative value risk reward assessments.

The interest rate markets continue to assess the arguments for the worthiness of a narrow or broad index sample. It is time to assess the merits of combining Qualifying Asset Managers evolving investment policies whilst the interest rate benchmark methodology is challenged to reflect the changing nature of Wholesale Funding.

Q7. Should the timing of the transactions in scope for calculating BBSW be changed? Three options to consider are:

a. including all transactions taking place up to the time of the rate set (i.e. morning transactions prior to 10am)

b. including all transactions taking place over the 24 hours prior to the rate set.

c. moving the rate set to a later time (e.g. 11am) to provide a wider window for the transactions underlying BBSW to be contracted up to the time of the rate set.

A7. Curve Securities feels the market has a preference for Option (a) or a specific 1-hour window between 9.00am and 10.00am. Clients have responsibilities to perform tasks within specific timeframes to meet set workflow deadlines.

Any move to a later time would compromise the front office to comfortably meet the existing cut off times 3rd party custodians and internal finance departments require to authenticate trades and issue validated payment instructions.

The majority of rate matrices arrive from our partner ADIs in the 20 -30 minutes following the publishing of BBSW at 10.15am.

If Option (c) were under consideration, we envisage a potential 1-hour delay in the distribution of pricing information. This would set off unquantifiable workplace pressures on the whole end to end investment process and launch unforeseeable change management issues across the whole investment landscape.