



AFMA BBSW Survey

Executive Summary of Findings

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1. Background

In August 2013, the Australian Financial Markets Association (AFMA) conducted a survey to better understand the needs of reference rate users. The survey sought to understand the demand for interest rate benchmarks in general and the current usage of the Bank Bill Swap (BBSW) benchmark rate more specifically.

A forum organised by AFMA that facilitated discussion between senior Reserve Bank officials and industry participants highlighted the need for more information on the requirements for reference rates by a range of users. Amongst other things, the survey sought to identify opportunities for the industry to support the development of new reference rates.

In March 2013, the Bank for International Settlements released a report, *Towards better reference rate practices: a central bank perspective*, which considered the possible risks for monetary policy transmission and financial stability that may arise from market participants using reference interest rates which embody economic exposures other than the ones they want or need. The report suggested that there is a strong case for enhancing reference rate choice, as having more than one viable and complementary benchmarks may lead to reduced systemic risk.

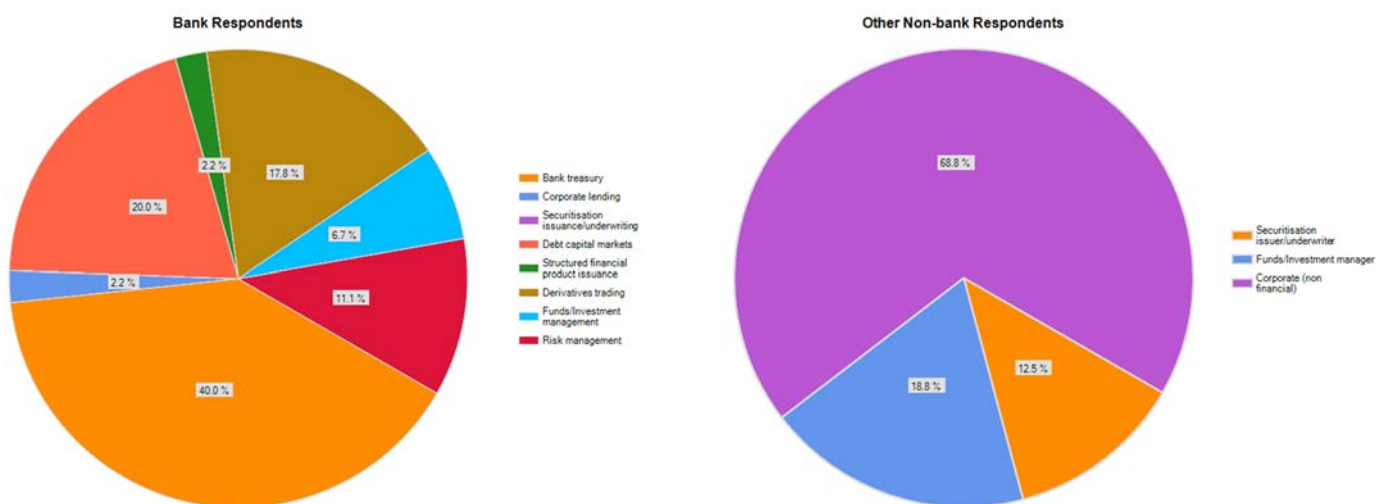
A range of respondents contributed to the survey, and a comprehensive report of findings was made available to them. This condensed report is being made available to interested stakeholders. Survey respondents who would like access to the comprehensive report should contact the AFMA Secretariat at secretariat@afma.com.au.

2. Methodology

The survey was distributed to a range of financial market participants, reflecting the diverse range of reference rate users, including bank and corporate treasurers, debt issuers and arrangers, securitisation entities, derivatives users, fund managers and financial product issuers.

Separate surveys were designed and issued to bank and non-bank respondents. Bank respondents were asked to provide feedback from the business unit/function level, as it was anticipated that different businesses within a banking institution may have different uses of benchmark rates. All other non-bank respondents were asked to answer the survey from a whole of organisation perspective.

In total 83 survey responses were collected; 46 from bank respondents and 37 from other non-bank respondents.



Of the bank respondents, 40 per cent were from the bank treasury business function, followed by 20 per cent from debt capital markets and 18 per cent from derivatives trading. Of the non-bank respondents, 69 per cent of surveys were completed by non-financial corporates, 19 per cent by fund managers and 12 per cent by securitisation issuers. Five other non-bank survey responses were also received from non-bank financial institutions and various government agencies.

3. Executive Summary of Findings

Survey respondents indicated that they used BBSW as a reference rate for a diverse range of their business activities, including:

- Lending and investment;
- Debt raising;
- Over-the-counter (OTC) derivatives trading;
- Structured financial products; and
- Other activities including as a valuation tool for financial instruments or for performance assessment, and risk management.

With the exception of OTC derivatives trading, the tenor used most extensively for all of these activities was 3 month BBSW, followed by 1 month BBSW and 6 month BBSW. For OTC derivatives trading activities, 3 month BBSW was also the most extensively used tenor, however, 6 month BBSW recorded a higher rate of usage than 1 month BBSW. The extensive use of these three tenors was the same for both bank and non-bank (including corporate, fund manager and securitisation issuer) respondents. Bank respondents, however, were more likely to engage in a wider range of activities and make greater use of the 2, 4 and 5 month tenors.

For these business activities, a significant majority of respondents used BBSW only. Lending and investment and OTC derivatives trading activities were the only areas where respondents indicated that reference rates other than BBSW were used widely. In particular, business loans, interest rate swaps, cross currency swaps and debt securities were the areas that recorded a material use in other reference rates; with 27 per cent, 23 per cent, 23 per cent and 21 per cent of respondents respectively using rates other than BBSW for these activities. On average, only 27 per cent of respondents who used other rates for these activities used these rates more intensively than BBSW. Most respondents who used rates other than BBSW used these rates less than, or about the same as, BBSW.

Respondents suggested that the most important attributes of an AUD reference rate, in order of ranking, are:

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

Overall, all of the listed attributes were rated highly by respondents. While reliability was rated highly by both bank and non-bank respondents, bank respondents placed more emphasis on frequency whereas non-bank respondents preferred robustness. Representativeness was rated by all respondents as least important, with over 15 per cent of respondents indicating that this attribute is not important or only somewhat important.

A significant majority of respondents indicated that they have no preference to use alternative reference rates (including the overnight cash rate, overnight indexed swaps, a risk-free rate, a rate that includes credit risk other than that of banks and longer-tenor reference rates) over BBSW. The most popular alternatives were the overnight cash rate, longer-tenor reference rates and overnight indexed swaps, with around 30 per cent of respondents indicating that they would prefer these alternatives over BBSW. Banks were more likely to favour overnight indexed swaps; corporates a longer tenor reference rate; fund managers the overnight cash rate; and securitisation issuers provided equal preference to the overnight cash rate, overnight indexed swaps and a rate that includes credit risk other than that of banks.

Respondents suggested that there are a range of impediments in the use of the overnight cash rate and overnight indexed swaps (referenced to the cash rate) as alternative rates, including:

- Lack of credit risk premium to reflect bank exposure;
- The need to interpolate rates and associated transparency and error issues;
- The rates for overnight indexed swaps are not readily available;
- Basis risk and the mismatch of timing for term transactions;
- Lack of access to rate set information for the interbank cash rate;
- Lack of term premium/no tenor risk priced in;
- Rates may not correctly reflect underlying market movements in the short term;
- Volatility of rates;
- Lack of market acceptance;
- Wide market acceptance of BBSW;
- Inability to invest in securities or fund at the overnight cash rate;
- Irrelevance of a derivatives benchmark for investments in physical securities;
- Legacy trades;
- Reliability and robustness of rates; and
- Inability to hedge.

Respondents suggested that a range of factors are shaping the demand for the establishment of new AUD benchmark rates. Over 48 per cent of respondents saw changes to collateral arrangements as either relevant or very relevant; compared to 45 per cent for pricing CVA and 37 per cent for changes to collateral arrangements.

Overall, respondents' feedback on their experiences in using BBSW were positive. Several respondents suggested that the seasonality of the BBSW rate set is quite variable and as such can have a material impact on the pricing of derivative instruments and increases the complexity for rate users. There was a suggestion that an index should be developed, incorporating a range of measures (including deposit rates) that provides a more accurate reflection of banks' funding costs.