



Consultation – Bank Paper Maturity Convention Early/Late to Actual Maturity $-/+$ Five Business Days

13 December 2021

NEW ZEALAND FINANCIAL BENCHMARK FACILITY

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Submission contact details

The New Zealand Financial Benchmark Facility (NZFBF), a subsidiary of the New Zealand Financial Markets Association (NZFMA), invites submissions on this consultation document by 5pm on Monday, 31 January 2022.

Address submissions and enquiries to:

(Email)

submissions@nzfbf.co.nz

Subject line: Bank Paper Maturity Convention – Proposed Change

(Hard copy)

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Submission Results

NZFBF will keep all individual submissions confidential. It will however publish an anonymised summary of the submissions as soon as possible after the closing date.

1. Background

Following a discussion at the 7 October 2021 NZFMA Rates Committee, and subsequent discussions with the BKBM Price-makers, NZFBF is consulting on a proposed change to the bank paper maturity convention from early/late to actual maturity date +/- five business days. No changes are proposed to the current BKBM Operating Rules and Principles.

To date, the bank paper maturity convention has been based on an early/late month. Early means maturities on business days from the 1st to the 15th of the month and late refers to maturities on business days from the 16th to the end of the month. In practice, this allows a bank issuing paper to determine the maturity date within this time frame.

Prime Bank eligible securities (bank paper) are traded in the local New Zealand market and represent the rates that banks are willing borrow from, or lend to, one another for terms out to twelve months and more typically for terms of one to six months. The rate at which bank paper trades contain a credit premium to the comparable risk-free interest rate curve.

Bank paper is traded in New Zealand for a number of legitimate purposes. These include:

- price and/or volume discovery.
- obtaining funding.
- managing a cash position by investing in bank paper.
- hedging interest rate risk.

Below are two examples of the early/late convention and the proposed convention:

I.

Transaction date	10 November 2021
Transaction term	Three months
Three-month maturity date	10 February 2022

Early/Late – Bank paper can mature on any business day from 1 February to 15 February 2022.

Actual maturity date +/- five business days - In this example, the proposed convention allows a bank issuing paper to determine the maturity date on any business day from 3 February to 17 February 2022.

Both conventions produce maturity bands with similar dates.

II.

Transaction date	1 November 2021
Transaction term	Three months
Three-month maturity date	1 February 2022



Early/Late – Bank paper can mature on any business day from 1 February to 15 February 2022. This is unchanged from example I above.

Actual maturity date +/- five business days - In this example the proposed convention allows a bank issuing paper to determine the maturity date on any business day from 25 January to 8 February 2022.

Both conventions produce maturity bands with quite different dates.

2. BKBM

BKBM is New Zealand's interest rate benchmark which is set each business day for terms of one to six months. The benchmark is set via a two-minute rate-set window held between 10:20 and 10:22am using broker venues. BKBM one-, three-, and six-months rates are set using transaction data and/or live executable prices, for bank paper, provided by approved price-makers. Two-, four- and five-month rates are interpolated from the one-, three- and six-month rates.

3. Interbank market

Interbank trading of bank paper can occur throughout the day, either direct or via brokers, for the purposes noted in the introduction. Additionally, trading can occur as a result of BKBM price-makers managing limits with other price-makers ahead of the rate-set.

Questions

1. *If adopted, should the new maturity convention apply to both BKBM and the Inter-bank bank paper market? If not, please provide an explanation.*

4. Early/late convention

The early/late maturity date convention has been in place for a number of years and was originally consistent with conventions used in other countries. In recent times, countries such as Australia (May 2018), have phased out the early/late convention and moved to the actual maturity date, in some cases with a number of business days either side.

The early/late convention in New Zealand has operated relatively well and although bank paper trading volumes have decreased over time this cannot be directly attributed to the maturity convention.

From time to time, there is volatility in the BKBM rate when the maturity band changes from early to late or late to early. This volatility is usually small (around two basis points), although there have been instances of larger moves such as the seven-basis point move in mid-September 2021. These movements sometimes reflect other influences like a move in related

markets such as the overnight indexed swap. This typically occurs when the yield curve is steeper and the Central Bank is actively adjusting monetary policy (i.e., OCR).

5. Actual Maturity Date \pm 5 Business days

As noted above other jurisdictions have moved away from the early/late maturity convention. In Australia, BBSW moved to the actual maturity date \pm five business days in May 2018. In December 2020, the maturity convention was adjusted further to \pm five/ \pm ten business days for the one-month tenor and \pm ten/ \pm ten business days for the two-to-six-month tenors. NZFBF understands that this change was made to increase the number of transactions in the calculation and increase tenor formation using transactions.

Other reasons for adopting this convention include the BKBM tenor more closely aligning to the tenor it represents and a smoother bank paper curve.

6. Feedback to date

NZFBF initially engaged with BKBM price-makers on this matter and received the following feedback:

Liquidity

Given the relatively low levels of trading in BKBM the question of the potential impact on liquidity of such a change is important. It is difficult to estimate the impact on liquidity if the maturity convention is changed and this is highlighted in the varied responses received by NZFBF. Responses ranged from the potential for liquidity to fall, due mainly to the shorter run-off time of bank paper, to there being little change expected, to the potential for an increase in liquidity. The latter based on the ability to issue one day and buy the next if the issued paper fell outside the maturity band. One respondent also suggested trading could emerge in the two-, four- and five-month tenors.

Question:

- II. *What, if any, impact would you expect to see on liquidity for BKBM if the maturity date convention for NZ bank paper is changed from early/late to the actual maturity date \pm five business days? Why?*

Other impacts, positive or negative

The comments here noted the proposed maturity convention would be easier to administer and explain, and have the potential to provide more confidence in the benchmark. Other

comments reflected those noted in point 5. Namely, the BKBM tenor will more closely align to the tenor it represents, alignment with global methodology and a smoother bank paper curve.

Question:

III. Do you think the proposed change will have any other impacts, either positive or negative, on the BKBM rate set?

Issues to consider

Price-makers suggested there may be some negative consequences of moving to the proposed convention. They related to the early run-off of issuance if paper were issued to the dates prior to the actual maturity date (i.e., it could only be traded for less than five business days in the BKBM rate-set). A respondent suggested that prime-paper issuance could be set at a minimum of the actual maturity date + five business days. Another respondent suggested that price-makers could commit to price the currently non-traded tenors (two-, four- and five-months).

It was also noted that if the convention was changed it would need to be clearly defined and NZFBF would need to ensure communication of the change reached all market participants.

Questions:

- IV. Do you support the change in the maturity convention for bank paper from early/late to actual maturity date +/- five business days? Please provide an explanation.*
- V. What other issues should NZFBF consider when considering the proposed change to the maturity convention for bank paper?*
- Specifically:*
- VI. Should NZFBF consider an adjustment to the numbers of business days either side of the maturity (e.g., +/- ten business as adopted by BBSW in late 2020)?*
- VII. Should BKBM price-makers commit to pricing the two-, four- and five-month tenors? Please provide an explanation.*
- VIII. Do you support the suggestion of primary issuance being set at the actual maturity date plus five business days?*

7. Timeframes

NZFBF proposes the following time frames (approximately):

- Consultation closes 31 January 2022.
- NZFBF, in consultation with the NZFMA's Rates committee, consider responses to the consultation and identify next steps by mid-February 2022.



- NZFBF reports outcomes to the NZFBF Board in late February 2022.
- Consultation results and proposed next steps released early March 2022.
- Convention change, if agreed, implemented April 2022.

Question:

IX. Do you have any comment on the proposed process and timeframes noted above?

Summary of questions

Proposed change of bank paper maturity convention from early/late to actual maturity date +/- five business days.

Questions:

- I. If adopted, should the new maturity convention apply to both BKBM and the Inter-bank bank paper market? If not, please provide an explanation.*
- II. What, if any, impact would you expect to see on liquidity for BKBM if the maturity date convention for NZ bank paper is changed from early/late to the actual maturity date +/- five business days? Why?*
- III. Do you think the proposed change will have any other impacts, either positive or negative, on the BKBM rate set?*
- IV. Do you support the change in the maturity convention for bank paper from early/late to actual maturity date +/- five business days? Please provide an explanation.*
- V. What other issues should NZFBF consider when considering the proposed change to the maturity convention for bank paper?*
Specifically:
- VI. Should NZFBF consider an adjustment to the numbers of business days either side of the maturity (e.g., minus/plus ten business as adopted by BBSW in late 2020)?*
- VII. Should BKBM price-makers commit to pricing the two-, four- and five-month tenors? Please provide an explanation.*
- VIII. Do you support the suggestion of primary issuance being set at the actual maturity date plus five business days?*
- IX. Do you have any comment on the proposed process and timeframes noted above?*