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Consultation Summary – BKBM Bank Paper Maturity Convention

7 March 2022

NEW ZEALAND FINANCIAL BENCHMARK FACILITY

Level 12, ANZ Centre, 171 Featherston Street, Wellington, 6011
Phone: 04 499 9169 | Email: info@nzfbf.org | Website: www.nzfbf.org

Introduction

The purpose of the consultation was to invite responses on a proposed change to the bank paper maturity convention from early/late to actual maturity date -/+ five business days, following a discussion at the 7 October 2021 NZFMA Rates Committee, and subsequent discussions with the BKBM Price-makers.

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.

The consultation sought feed-back from all NZFMA stakeholders, including NZFMA members, benchmark subscribers and other interested parties, on the proposal to change the bank paper maturity convention.

The consultation opened on 13 December 2021 and closed on 31 January 2022. Since the consultation closed NZFBF has collated the responses and the discussed the matter internally, with the BKBM price-makers and with the NZFMA and its Rates Committee.

Summary of results

NZFBF received feedback from five institutions on its consultation for the proposed change in the maturity convention for bank paper. The five institutions represent banks located in New Zealand. Below is an anonymised summary of the responses to the nine questions posed, along with NZFBF's next steps.

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.*

Summary

All five respondents supported the new maturity convention applying to both BKBM and the inter-bank bank paper market. Supporting comments included:

- Consistency of approach and support efforts to ensure all trading executed during BKBM two-minute window.
- Different conventions would create unnecessary complexity and contra to ensuring markets are fair, efficient, and transparent.
- All bank paper should remain fungible.

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?*

Summary

Four of the respondents expected little or no material change. The remaining respondent noted there may be potential for lower liquidity if paper was issued to the earliest date in the issuance window. Comments:

- Little change to liquidity. May condense liquidity into shorter timeframe and should encourage “off the run tenors”.
- Liquidity impact to be neutral. Most transactions are related to bank balance sheets and this change should not impact demand for and supply of bank paper.
- No material impact on liquidity. -/+ 5 business days is roughly analogous to current half month window allowing banks to make informed liquidity decisions.
- No material impact on liquidity.
- Potential for lower liquidity given paper issued today to the earliest maturity date (maturity -5 business days) becomes ineligible the next day. Likely increase the amount of paper switching outside BKBM window to free up credit limits.

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

Summary

The five respondents largely saw positive impacts from the convention change. One respondent noted potential for liquidity issues if paper issued to maturity date – 5 business days. Comments:

- No. Convention much easier to administer and explain. May entice new participants. More confidence for IRS market that floating rate-sets will not be volatile around 15th of the month.
- Positive impacts – More closely align underlying OIS to the 90-day tenor. Minimize sharp moves driven by longer OIS run associated with the new bucket. More transparency of day-to-day change in BKBM. Reduce uncertainty around rate-set risk for NZ IRS participants. Easier to explain and understand. BKBM more closely aligned with BBSW
- Negative impacts – Paper transacted near T-5 likely to be less liquid. BKBM price-makers may be required to manage counterparty credit limits more actively.
- More closely align BKBM tenor to the term it represents. Reduce large one-days movements currently between buckets, assisting with integrity.
- Smooth early/late volatility when the curve is steep.
- Better representation of a date to date run for BKBM. Reduce volatility in BKBM when moving to a new period under early/late maturity convention.

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.*

Summary

Four respondents supported the change while one respondent suggested the change should apply to secondary market paper and primary issuance should be date to date + 1 to +5 business days. Comments

- Alignment to global best practice makes sense with a more easily understood process.
- Smoother BKBM rate-set, easier to explain and understand and consistent with IOSCO objectives (fair, efficient and transparent markets).
- Tenor more aligned to term and reduction in current unnecessary day to day volatility. No material adverse effects expected. Important to clearly define the revised maturity convention, in particular relating to non-business days
- Agree for secondary paper. For primary issuance where paper can be issued to T-5 and become ineligible next day, suggest that primary issuance is date to date plus 1-5 business days, so paper remains on the run for longer.

V.	*What other issues should NZFBF consider when considering the proposed change to the maturity convention for bank paper?*
	Summary One respondent made the following point: • May be occasions around extended public holidays where there could be a substantial extension of the maturity date, potentially resulting in a large move in BKBM compared to the day prior. However, new convention will still provide a much less volatile BKBM rate-set.

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)?*
	Summary Four respondents supported -/+ 5 business days, with one of these respondents suggesting -/+ 10 business days could future proof BKBM. The remaining respondent had no firm preference noting a longer timeframe could lessen maturity concentration risk. • BBSW has a much larger pool of participants that the respondent assumes want date specific trades for investment needs. BKBM solely used for liquidity and cash management. Could future proof BKBM if number of business days was widened. • -5/+5 business days provides enough flexibility and is a sufficient window to issue paper. -/+ 10 business days could lead to rate that is less representative. • Support proposed number of business days. Longer window would have unintended consequences creating extra volatility. • No firm preference. -/+ 10 business days would lessen maturity concentration risk. Unlikely to increase traded volume. • Do not support -/+ 10 business days as it introduces significant technical complexities.

VII.	*Should BKBM price-makers commit to pricing the two-, four- and five-month tenors? Please provide an explanation.*
	Summary Four respondents did not support pricing 2-, 4- & 5-month tenors in BKBM. One respondent did support pricing for these tenors and noted it could dilute liquidity in the 1-, 3- & 6-month tenors. • Yes. Could dilute trading in the 1-, 3- & 6-month tenors. Equally may introduce or entice other market participants.

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- No. Not reference rates in any standard derivative products. Smooth daily changes in 1-, 3- & 6-month tenors, using the new convention, should mean the interpolated 2-, 4- & 5-month tenors are less volatile. Trading 6 tenors could reduce liquidity. Two-, 4- and 5-month tenors can trade outside the rate-set window.
- No. Minimal demand and minimal benchmarking is done off these tenors.
- No, current interpolation methodology seems to be working adequately.

VIII. Do you support the suggestion of primary issuance being set at the actual maturity date plus five business days?

Summary

Three respondents supported the proposed -5/+5 business days. Two respondents supported primary issuance being set as date to date plus 1 to 5 business days. The concern with primary issuance is the potential for issuance to the earliest date (-5 business days) leading to lower liquidity as paper becomes ineligible the next business day. One of the two respondents also suggested -5/+10 business days for the one-month tenor to account for holiday periods. Comments:

- Yes. Investigation is needed into -5/+10 days for the one-month tenor to account for holidays.
- No. We prefer -/+ 5 days as it gives sufficient flexibility for issuance dates.
- Comfortable that primary issuance is treated the same as secondary trading (i.e. -/+ five business days from actual maturity
- Think it is unnecessary as similar outcome achieved through the -/+ 5-day convention. Less optimal in terms of liquidity management.
- Issuers of prime paper issue date to date plus 1 to 5 business days (noted question as framed suggests issuer can only issue to maturity date plus 5 business days).

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

Summary

Two respondents were comfortable with the implementation date of April 2022. Two respondents noted more time was needed for system changes and the market to adjust and suggested three months (June 2022). The remaining respondent did not answer the question.

- Three months required to implement change.
- Likely have an impact of bank bill futures and single period swaps (SPS) so consideration needs to be given to this. Suggest a minimum of 3 months given the majority of the SPS reset risk is traded in this window, meaning

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most trades dealt under the early/late methodology are not unfairly impacted. Provides participants sufficient time to allow for communication and understanding of the change in methodology.

- Comfortable with the proposed timetable.
- Timeframes influenced by the ability of brokers to update and communicate changes to their pages well ahead of implementation date. Suggest implementation April 2022.

Summary

- All respondents support the change in the bank paper maturity convention from early/late to actual maturity date -/+ a number of business days.
- All respondents supported the new convention applying to both BKBM and the inter-bank bank paper market.
- Four respondents expected little or no change to liquidity due to the convention change. One respondent noted liquidity could be impacted if all primary issuance was to the earliest date (Maturity date - 5 business days).
- All respondents saw positive impacts for BKBM; More representative, reduction of volatility & easier to administer and explain. One respondent noted potential liquidity issues if paper issued to shortest date (Maturity date - 5 business days).
- The majority of respondents did not support the convention being actual maturity date -/+ 10 business days stating a longer window could create unintended consequences and technical complexities.
- The majority of respondents did not support also pricing the 2-, 4- & 5-month tenors in BKBM noting potential impacts on liquidity.
- Three respondents support the convention date to date -/+ 5 business day convention. One respondent recommended primary issuance be set at date to date + 1 to +5 business days to avoid potential liquidity issues if issuance was to maturity date – 5 business days.
- Two respondents suggested a longer implementation period of three months was required to allow for system changes and markets to adjust to the new convention.

Next Steps

Following further discussion within NZFBF and NZFMA, with the NZFMA's Rates committee and BKBM price-makers the following will be implemented:

- These consultation results and next steps will be released via the NZFBF website and emails to stakeholders on 7 March 2022.
- The maturity convention for bank paper will change from early/late to actual maturity date +1/+5 business days for primary issuance and actual maturity date -5/+5 business days for secondary issuance. An example follows:

Issuance	Term	Start date	Maturity date	- 5 business days*	+ 5 business days
Primary	3 months	7 March 2022	7 June 2022	n/a	8 June 2022 9 June 2022 10 June 2022 13 June 2022 14 June 2022
Secondary	3 months	7 March 2022	7 June 2022	3 June 2022 2 June 2022 1 June 2022 31 May 2022 30 May 2022	8 June 2022 9 June 2022 10 June 2022 13 June 2022 14 June 2022

* Note 6 June 2022 is a public holiday in New Zealand.

- The convention change will be implemented in a two-month time frame on Monday 9 May 2022.