NZFMA Consultation

New Zealand Credit Market Closing Rates – Moving bond valuations from yield to clean-price

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New Zealand Financial Markets Association | Level 12, ANZ Centre, 171 Featherston Street, Wellington 6011, New Zealand
T: +64 4 4999169 | E: info@nzfma.org | W: www.nzfma.org

Submission contact details

The New Zealand Financial Markets Association (NZFMA) invites submissions on this consultation document by 5.00pm on Friday, 5 February 2021.

Address submissions and enquiries to:

(Email)
submissions@nzfma.org
Subject line: Moving NZNG bond close valuations from yield to price-based

(Hard copy)
John Groom
New Zealand Financial Markets Association
PO Box 641
Wellington 6011
New Zealand

Submission Results

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

Introduction

The NZFMA has been producing closing rates for New Zealand Credit Markets (NZNG) as an end of day valuation tool since January 2010. Today, closing rates are calculated each business day for over 200 securities, including Bonds and Floating Rate Notes (FRNs). Bonds are valued on a yield basis and FRNs on a price basis. Issuers in the New Zealand Credit Markets include the Local Government Funding Agency, Kauris[1], Registered Banks and other financial institutions.

As New Zealand's Credit Markets have developed, the instruments being issued have become more complex. In particular, the advent of resettable bonds (without a call date) and the RBNZ's announcement in 2020 to not allow Tier 2 capital instruments to be called, until further notice, has resulted in unclear maturity dates or nonsensical implied yields to a call or reset, due to an implicit and often incorrect assumption of a par price at that date. In addition to this, the potential for distressed credit, may result in very high yields which don't represent a fair expected return.

The NZFMA's Credit Market committee has been considering these issues and recently concluded that price-based closes present the best solution to the problem, as the clean price gives a value to the security without having to make assumptions around calls and resets. If clean price closes are adopted, Bloomberg would no longer have the NZFMA's closing yields to calculate the implied spread to swap as is currently the case. However, priced-based valuations are potentially less well understood in the New Zealand market with money markets and longer-term bond markets operating on a yield basis for a number of years. As a result, this consultation seeks feed-back from market participants and closing rate subscribers on a proposal to transition all NZNG closes to a clean price valuation. To be clear, this consultation refers specifically to the publication of the NZFMA's credit market closing rates. It does not refer to the over the counter market convention for credit market instruments, where it is likely most bonds will continue to trade on a yield basis.

The NZFMA contacted a number of Financial Market Associations in other jurisdictions to ascertain best practice for the valuation of fixed income instruments. It was clear from the responses that best practice is to value these instruments on a price basis.

The NZFMA is aware that the proposed change could have impacts for end users' systems that would require changes to be made. For example, some users may need to convert the closing prices into yields before the data can be loaded into their systems. We want to understand the significance of these changes and the lead times that may be required to adjust systems to accept this change. This will help guide the notice period required if such a change is adopted.

[1] A Kauri bond is a New Zealand dollar denominated security, registered in New Zealand and issued by a foreign issuer, typically Supranational. Settlement takes place in New Zealand initially. The security can then be held in other depositories around the world.

Questions

I. *This consultation proposes changing the valuation method of the NZFMA's Credit Markets Closing Rates from a yield basis to a clean price basis. Do you agree with this change? If not, can you please provide information supporting your view?*

II. *The consultation also notes that the NZFMA's Credit Market closing rates might no longer contain the implied spread, as currently calculated by Bloomberg. Does this create any issues for your organisation?*

III. *If NZFMA's Credit Market closing rates moved to clean price-based valuations this may have system implications for your organisation? How much lead time would be required to update your systems?*

IV. *Would the proposed change have any other impacts on your organisation or your processes? Can you please provide some detail and the expected lead time required to overcome them?*

V. *The consultation document highlights the issues with using yield-based valuations, especially for bonds with optionality. Should the NZFMA and the Credit Market Committee consider other options to overcome this issue? What are they?*