

**NZFMA Consultation Feedback & Proposed Next Steps**

Credit Market Closes (NZNG) – Yield to Clean Price

30 March 2021

November 2020

January 2019

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**Introduction**

The purpose of the consultation was to propose that the closing rates for the NZFMA’s Credit Markets bond service move from yield to clean price. It was noted that 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.

The NZFMA’s Credit Market committee[[1]](#footnote-1) 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.

The consultation sought feed-back from market participants and closing rate subscribers on a proposal to transition all NZNG closes to a clean price valuation. The consultation referred specifically to the publication of the NZFMA’s credit market closing rates and did 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 consultation closed on 5 February 2021 and since this time the NZFMA’s Credit Market committee have considered the responses and discussed next steps. This document provides a summary of the feedback to the questions posed in the consultation and the Credit Market committee’s proposed next steps.

**The NZFMA invites submissions on the proposed next steps by 5.00pm Friday, 9 April 2021.**

Address submissions and enquiries to:

submissions@nzfma.org

**Summary of results**

The NZFMA received feedback from twelve institutions on its consultation for the proposed change in the format of the NZFMA’s Credit Market closing rates (closes) from yield to clean price. Below is a summary of the responses to the five questions posed, along with notes relating to the NZFMAs’ Credit Markets committee discussion of those responses and proposed next steps.

***Questions***

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| 1. 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? |
| **Summary**  Five institutions supported the change to clean price, five did not support the change and two were neutral.  Those supporting the change noted the following points:   * Clean price works as long as the spread to swap is available; * Aligns with international best practice; * Difficulties in determining when a bond should change from yield to price creates ambiguity between banks and platforms. This can lead to reputational and compliance issues; * Does not change how banks quote to clients (i.e. Yield); * NZX determines how its quotes (yield or clean price).   The institutions not supporting the change noted:   * Backward step requiring end users to back solve yield and spread. Perhaps Bloomberg could take on this role?; * Yield works well for market participants, especially retail. * Non-vanilla issues, that create the issues noted above, represent a small proportion of the market in both number and value terms; * Non-vanilla securities structured to appeal to retail investors who better understand yield; * Detrimental to the usability of data. Yields allow for easy comparison with other products including retail deposits; * Current ban on tier two instruments is temporary and will likely be removed soon.   One of the neutral institutions noted the following matters should be considered before a decision is made:   * if yield instruments are migrated to price traded instruments NZX Participants’ WRAP portfolio systems will require a change to the instrument’s ISIN and for the instruments to be recognised as new instruments; * the migration of yield instruments to becoming price traded would require the consent of the issuer of the instrument; * switching instruments from being yield to price-traded (or vice versa) is difficult, and not something that can be easily reversed (particularly for Tier 2 instruments with long tenors and multiple call dates); * the effects on NZX Participants’ reporting (noting some participants have suggested this is a concern while others have noted current reporting is done on a price basis); * the effects on investors if the NZNG yield information is not available; and * whether there is behaviour to indicate that there are concerns in terms of the accuracy of yield pricing, as is suggested in the consultation paper.   Credit Market Committee Discussion  *It appears the proposal to change the closes to price-based has been interpreted as banks intending to change their trading conventions which is not correct. Should this proposal be agreed, it is expected banks would continue to trade in the usual manner. It was noted that 5 of the 12 responding organisations favoured a move to price-based closes, although some of the committee thought that any misconception that occurred may have skewed the consultation results. Five favoured yield based closes with non-vanilla bonds moving to price-based. Two respondents were neutral to the proposed change.*  *As a result of the split feedback and the points raised the Credit Market Committee concluded that all vanilla bonds will continue to quoted as a yield for the NZFMA closes. Non-vanilla bonds and FRN closes will be published as a clean price.*  *The banks whose marks are scraped for the NZFMA closes will determine which of the current bonds on issue are non-vanilla and will also follow the same process for all new bonds that are issued. Bonds with a straight bullet and no optionality will be valued using a yield and all other bonds will be clean price.*  *The committee are not proposing changes to market making quote methods and each bank is free to quote as it sees fit (e.g. price to reset, call, clean price, dirty price etc.).* |
| 1. 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? | |
| **Summary**  *Five institutions noted the availability of the spread was important. Points noted:*   * *Would create a significant information gap affecting transparency;* * *Spread history would be lost unless they calculate (backward step).*   *Three institutions do not use the spread and the remaining four institutions gave no response.*  Credit Market Committee Discussion  *Given the decision is question I, vanilla bonds will continue to be published on Bloomberg with a spread. A Bloomberg spread will not be available for non-vanilla bonds.* | |

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| 1. 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? |
| **Summary**  Eight institutions noted that system changes would be required with changes taking between two weeks and three months. One institution noted that with current work demands this change would be better managed in the second half of 2021. Two institutions requested a parallel run of yield and clean price for one to two weeks.  Four institutions did not respond to the question.  Credit Market Committee Discussion  *The NZFMA expects it can implement this change relatively quickly and will consider a parallel run for a short period of time (i.e. four weeks). Vanilla bonds, non-vanilla bonds and FRNs will appear on the same NZNG spreadsheet, published via email. Data will be posted to three pages on Bloomberg (vanilla bonds, non-vanilla bonds and FRNs).* |

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| 1. 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? |
| **Summary**  Most institutions covered their points in question three. One institution asked for further consultation before the final decision is made, while another suggested the use of clean price for closes would likely impact on secondary market trading.  Credit Market Committee Discussion  *Not discussed by the Credit Markets committee. This document allows further feedback on the proposed way forward.* |

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| 1. 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? |
| **Summary**  Five institutions noted that clean price could be used for non-vanilla bonds and all other bonds should remain on a yield basis, with one of those institutions also suggesting that as an alternative, NZDX could provide the yield for non-vanilla bonds.  One institution noted that end users would have the capability to convert clean price into yield if that is what they required.  Six institutions provided no response.  Credit Market Committee Discussion  *See response in Question I.* |

**Next Steps**

The NZFMA and its Credit Market committee propose the following:

* Closing rates for non-vanilla bonds will be changed from yield to clean price;
* All closing rates for vanilla bonds will remain on a yield basis. A spread will also be provided;
* The committee are not proposing changes to market making quote methods and each bank is free to quote as it sees fit (e.g. price to reset, call, clean price, dirty price etc.);
* The banks whose marks are scraped for the NZFMA closes will determine which of the current bonds on issue are non-vanilla. A list of current non-vanilla bonds can be found in appendix one. The same definition and process will be used for all new Credit Market issues moving forward;
* The NZFMA will provide both a yield and clean price for non-vanilla bonds, via its daily emailed spreadsheet (NZNG)[[2]](#footnote-2), for a period of four weeks to allow institutions to make any necessary system enhancements (appendix two contains an example of the spreadsheet);
* Bloomberg will have three separate pages for vanilla bonds, non-vanilla bonds and FRNs. The page for non-vanilla bonds is GDCO 41021 1 1. Vanilla bonds and FRNS are on pages GDCO 34238 and GDCO 36519 respectively; and,
* The NZFMA will publish a market notice, on its website and via email, advising the implementation date of clean prices for non-vanilla bonds in due course.

**Appendix one**

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**Appendix two**

**Example of NZNG Spreadsheet showing Yield and Clean Price for Non-vanilla bonds for four week period**



1. The NZFMA’s Credit Market committee consists of participants from the NZFMA, banks, buy side, NZX and observers from Government organisations. [↑](#footnote-ref-1)
2. Pricing for non-vanilla bonds on other media (e.g. Bloomberg) will be changed to clean price from the implementation date. This is to avoid delays due to technical challenges. [↑](#footnote-ref-2)