

AONIA As An Alternative To One-Month BBSW In Australian Structured Finance Transactions

April 2, 2019

Key Takeaways

- S&P Global Ratings can incorporate a compounded AONIA as an alternative benchmark rate to the one-month BBSW in its cash-flow analysis of structured finance transactions
- BBSW should continue to exist, even if benchmarks in other countries such as LIBOR are phased out.
- Three- and six-month BBSWs are viewed as being more robust than one-month BBSW, however, and the RBA has encouraged financial market participants to consider alternatives, including AONIA.

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S&P Global Ratings has developed interest-rate curves for a monthly compounded Australian Interbank Overnight Cash Rate (AONIA) benchmark. We can incorporate the curves into our cash-flow analysis of structured finance transactions should a monthly compounded AONIA be included as a benchmark.

The Reserve Bank of Australia (RBA) has been encouraging financial market participants to consider whether an alternative benchmark to the one-month Australian bank-bill swap rate (BBSW) should be applied as the reference rate for interest payments on Australian residential mortgage backed securities (RMBS). The RBA has suggested AONIA as an alternative.

The administration and calculation of the BBSW has undergone a variety of reforms since 2013, culminating in a declaration by the Australian Securities and Investments Commission (ASIC) on June 6, 2018, that BBSW and AONIA are "significant financial benchmarks." S&P Global Ratings therefore considers that BBSW should continue to exist even if benchmarks in other countries such as the London Interbank Offered Rate (LIBOR) are phased out.

Changes to liquidity-coverage ratio requirements for Australian approved deposit-taking institutions have resulted in lower volumes of one-month bank bills issued to investors and, therefore, lower liquidity compared with three- and six-month paper. For this reason, the RBA and financial market participants have said three- and six-month BBSWs are more robust benchmarks.

When considering AONIA as a replacement benchmark to the one-month BBSW for Australian securitization transactions, we note some obvious differences. The one-month BBSW is a term

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rate, for example, whereas AONIA is an overnight rate. For this reason, S&P Global Ratings' AONIA curves assume that issuers seeking to use the cash rate as a benchmark would use the daily AONIA rates compounded over the applicable interest period. However, this means that the applicable interest rate would only be known at the end of the interest period, whereas with BBSW it is known at the start of the interest period.

Securitization transactions typically include the concept of a monthly "determination date" by which all of the cash-flow waterfall calculations must be determined and communicated to the trustee or administrator of the securitization issuer and "payment date" on which all payments, including interest on the securities, are made. The gap between the determination and payment dates varies from one transaction to the next, but generally ranges between two and five business days.

To allow for an operationally feasible calculation of the applicable compounded AONIA rate, issuers would need to consider a mechanism to determine the time period for the compounding calculation to allow the transaction parties to calculate the applicable rates and required interest distribution amounts.

Another difference between BBSW and AONIA is that BBSW is a lending rate, which includes various risk premiums such as credit and liquidity, whereas AONIA is the near risk-free rate published by the RBA. There has been a close relationship between backward-looking compounded AONIA and forward-looking one-month BBSW determined for the same period. However, because AONIA does not include the credit risk or term structure characteristics of BBSW, the former generally has been lower.

S&P Global Ratings will continue to monitor market developments in interest-rate benchmarks, both locally and globally.

Related Criteria

- Global Framework For Cash Flow Analysis Of Structured Finance Securities, Oct. 9, 2014

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