

## BBSW FALLBACKS IN RBA-ELIGIBLE SECURITIES

Global reform is underway to strengthen financial benchmarks and ensure sound practice in their use in the financial system. As part of this work program, market participants have been urged to increase contract robustness for financial products by including fallback provisions to apply in the case where the referenced benchmark rate is discontinued.<sup>1</sup> Although BBSW is currently a robust benchmark, this could change in the future. In March 2019, the Reserve Bank announced that it will require new securities that reference BBSW to include fallback provisions to be eligible collateral for repo with the Reserve Bank.<sup>2</sup>

The Reserve Bank plans to publish new eligibility criteria in the first half of 2021 which will require fallbacks for new BBSW-linked securities issued on or after 1 July 2022. Securities issued before 1 July 2022 will be grandfathered, except for internal asset-backed securities (self-securitisations). The Bank will engage directly with issuers of self-securitisations in advance of applying the new eligibility criteria to these securities.

The draft criteria outlined below set out the high-level principles the Reserve Bank will require fallbacks to meet. The criteria do not specify the fallback language to be included in security documentation; the Reserve Bank expects this to be developed by industry participants.

The Reserve Bank is aware of work streams currently underway related to benchmark reform, including those dealing with LIBOR transition and the development of industry standards for products that reference AONIA. Ahead of publishing the new eligibility criteria, the Reserve Bank is seeking to understand whether there are any issues it should be aware of, and how the timing of the development of fallbacks for BBSW-linked securities aligns with other work to strengthen financial benchmarks.

### Draft Eligibility Criteria

These criteria are not final and are subject to change. They will come into effect when published on the [Eligible Securities](#) page of the Reserve Bank website.

All floating rate notes (FRNs) and asset-backed securities issued on or after 1 July 2022, where BBSW is the relevant interest rate for the purposes of calculating coupons, must meet the following criteria in order to be eligible for purchase by the Reserve Bank under repo:

- Include at least one 'robust' and 'reasonable and fair' fallback for BBSW in the event that it permanently ceases to exist.
- A 'robust' fallback is one that clearly specifies the method for the calculation of interest that would apply for the purposes of calculating coupon payments. The fallback must also specify a clear and unambiguous trigger event after which the fallback would apply. Acceptable fallbacks would include those that reference AONIA (including AONIA plus or minus a fixed spread). Fallbacks that reference another benchmark interest rate may also be accepted at the Reserve Bank's discretion.
- A 'reasonable and fair' fallback is one that reasonably mitigates the impact on the economic value of the security in the event the fallback is invoked. A fixed-rate fallback would not be considered reasonable and fair for the purposes of these criteria.
- The robust and reasonable and fair fallback(s) must sit above any other fallbacks that rely on collecting dealer quotes, or on discretion – whether by the issuer, the calculation agent, or any other related or third party – in the fallback waterfall.

All self-securitisations, regardless of the date of issue, will also be required to include at least one robust and reasonable and fair fallback in order to be eligible. The Reserve Bank will give at least 12 months' notice before enforcing this requirement.

FRNs and other asset-backed securities issued before 1 July 2022 will not be subject to this requirement for eligibility. Nevertheless, the inclusion of robust and reasonable and fair fallbacks for such securities, depending on their length of time to maturity, is recommended as a matter of prudent risk management.

1 Financial Stability Board (2020), '[Reforming Major Interest Rate Benchmarks, 2020 Progress Report](#)', 20 November. IOSCO (2018), '[Statement on Matters to Consider in the Use of Financial Benchmarks](#)', Statement by the Board, 5 January.

2 Kent (2019), '[Of Bonds and Benchmarks](#)', Remarks at KangaNews DCM Summit, 19 March. See also Kent (2020), '[Benchmark Reforms](#)', Remarks to the Australian Securitisation Forum Virtual Symposium, 17 November.

## Questions

1. Are there any technical, practical or legal issues that would prevent industry developing fallbacks that meet these criteria?
2. Do these criteria provide sufficient flexibility for industry participants to develop fallback language that meets the requirements of each relevant market?
3. Assuming the Bank publishes the final criteria in the first half of 2021, is there sufficient time for industry participants to develop and implement fallback language for the criteria to come into effect on 1 July 2022? How does this align with current workstreams underway, such as the LIBOR transition and the development of industry standards for products that reference AONIA?
4. Are there any other issues related to fallbacks for BBSW-linked securities that the Bank should be aware of?

## Next Steps

This note may be shared with your members.

Responses to these questions can be provided in writing and/or a meeting can be organised to discuss any of the above.

Please respond **by Friday 12 March 2021** by email to [eligible\\_securities@rba.gov.au](mailto:eligible_securities@rba.gov.au)

Domestic Markets and Risk and Compliance departments

Reserve Bank of Australia

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