



# Reciprocal Purchase Agreements Conventions

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# AFMA Code of Conduct

AFMA promotes efficiency, integrity and professionalism in Australia's financial markets. The AFMA Code of Conduct (the Code) clearly articulates the ethical principles for minimum acceptable standards of behaviour and supports responsible decision making by firms and individuals engaged in financial markets activities.

All AFMA Financial Markets Members and Partner Members<sup>1</sup> are expected to observe the Code and operate with integrity, professionalism and competence. The Code is designed to support behaviors that put the interests of clients, the firm and the wider community ahead of personal or individual interests, and promotes confident participation by users in Australia's OTC markets.

The Code is presented in two parts – the [Ethical Principles](#) and the [Guidelines](#).

Market participants are reminded that they are generally expected to observe and adhere to the market standards and conventions<sup>2</sup> as set out below when engaging in any form of market dealing.

## 1. Description

The Australian repo market is characterised by trades between institutions purely for liquidity reasons (General Collateral) and those dealt to cover short trading positions (Specific Collateral). Repo transactions are also undertaken by the Reserve Bank of Australia (RBA) as part of its daily open market operations.

In undertaking repos the RBA accepts a range of Australian currency denominated eligible securities, defined as either General Collateral or Private Securities. General Collateral includes those issued by the Commonwealth Government, State and Territory central borrowing authorities, certain supranational organisations and foreign sovereign guaranteed organisations. Private Securities include bank bills (BABs) and certificates of deposit (CDs) issued by eligible Australian Depository Institutions (ADI's) and certain ABS and RMBS product.

A current description of eligible securities can be found on the RBA website:

<http://www.rba.gov.au/mkt-operations/resources/tech-notes/eligible-securities.html>

## 2. Products

### 2.1. Repurchase Agreement (Repo)

A repurchase agreement, also known as a Repo, RP, or sale and repurchase agreement, is a transaction involving the sale of securities together with a simultaneous agreement for the seller to buy back the securities at a future date at an agreed price. The repurchase price, which includes interest, will be greater than the original sale price.

### 2.2. Reverse Repo

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<sup>1</sup> As defined in the AFMA Constitution

<sup>2</sup> The Reciprocal Purchase Agreements Conventions are maintained by the AFMA Repo Committee

A Reverse Repo is the opposite of a Repurchase Agreement. Effectively one parties Repo is another parties Reverse Repo.

### **2.3. Open Dated/At Call Repo**

An Open Dated / At Call Repo is a Repo or a Reverse Repo for which no maturity date has been specified. The interest rate and term are renegotiated each Business Day. Either party may terminate the trade. See 3.10 for maturity convention.

### **2.4. Term Repo**

A Term Repo may have two characteristics:

- (a) where the rate and maturity of a Repo or Reverse Repo are agreed upon at the commencement of the transaction; or alternatively
- (b) where the rate is dealt at a spread to the RBA rate as bilaterally agreed.

### **2.5. Buy/Sell Back and Sell/Buy Back Transactions**

While a repo or reverse repo is technically a single transaction, a buy/sell back and a sell/buy back is a pair of transactions: in effect, a buy and a sell, or vice versa. Although this transaction is not a repo, it mirrors the economic effects of a repo. It is a structure where the spot and forward trades are executed at the same time using a cash rate to derive the forward yield from the spot yield. If a buy/sell back is open over a coupon date the return value is reduced by the coupon accrual value and its associated interest accrual. An example of a buy/sell back would be where counterparty A buys from and then sells to counterparty B.

Buy/Sell backs are covered in the GMRA if the buy/sell back annex is included or attached.

### **2.6. Intraday Repo**

Australian Office of Financial Management (AOFM) provides an intraday repo facility which is available to all members of the Reserve Bank Information and Transfer System (RITS) via the RBA to enable members to borrow government securities to facilitate orderly settlement of transactions. Members must repo eligible securities (GC) in exchange for the securities borrowed. AOFM does not charge a fee for intraday repos but does recover the cost of any related Austraclear fees (and associated GST).

If intraday repo is not unwound by end of day, then AOFM fees associated with the use of its Overnight Repurchase Agreement Facility will be incurred.

## **3. Dealing**

### **3.1. Collateral**

#### **3.1.1. General Collateral (GC)**

The AFMA definition of General Collateral (GC) is collateral that meets a non-specific maturity requirement but has a quality requirement. As distinct from GC transactions with the Reserve

Bank of Australia, a two-tier GC market, designated as “GC1” and “GC2”, is operated and classified as follows:

- GC1 – Actively traded AUD Commonwealth and Semi-Government Bonds. Treasury Notes and Commonwealth and State Government Indexed bonds
- GC2 – Any securities accepted by the RBA in daily liquidity dealings EXCEPT Global and Exchangeable securities

Note: Unless specified the term “GC” within these conventions refers to both GC1 and GC2.

### **3.1.2. Specific Collateral**

Specific Collateral is collateral that meets specific issuer, coupon and maturity characteristics. It is a particular bond/security issue sought by a dealer in order to meet a specific trading obligation, therefore specific quality and maturity of bond/security is sought and specified at the time of dealing.

## **3.2. Methods of Dealing**

Telephone, broker, Bloomberg system and/or Reuters Messaging are accepted methods of transacting business. Note: When dealers send a message to multiple counterparties, it is incumbent on the dealer to specify and identify it as a broadcast, denoting the amount and term required, following up with a broadcast once covered. In the absence of broadcast, participants may assume that any messages received without the flag broadcast are personal messages.

## **3.3. Electronic Dealing**

Platforms and communications networks as bilaterally approved for use between parties.

## **3.4. Business Days**

### **3.4.1. Good Business Day**

A good business day is defined as any day on which banks in the state of New South Wales (NSW) are generally open for business, or a day other than one on which banks in NSW are obliged or permitted to close, excluding Saturday and Sunday.

Essentially, NSW business days are weekdays (Monday to Friday) other than NSW public holidays as gazetted under the NSW State Government’s Banks and Bank Holidays Act 1912.

Australian OTC markets however generally tend to operate in a reduced capacity on gazetted NSW public holidays that are not similarly gazetted in Victoria, and on weekdays when banks in NSW are obliged or permitted to close.

### **3.4.2. Non-Business Day**

A non- business day is defined as any day on which banks in the state of NSW are generally obliged or permitted to close, including Saturday and Sunday.

In general, AFMA recommends that transactions should not be negotiated for settlement or price fixing (rollover) on a non- business day.

Other conventions can be utilised if agreed upon at the time of dealing.

### 3.5. Standard Transaction Size (market parcel)

Unless separately specified below, Market Parcel for GC repo transactions via brokers is \$50million cash value, with a maximum of 1 line of bonds/securities in a minimum of \$50 million cash value.

Market Parcel is negotiable for bilateral dealings.

For other repo transactions dealt via broker screen dealing systems the following standard transaction sizes apply, absent bilateral agreement of the two parties:

Repo period/term	Standard transaction size
1-7 days	\$20 million
Greater than 7 days	\$50 million

The repo transaction size for Inflation Index and Global /Exchangeable bonds:

Repo period/term	Index bond (Linkers)	Global/exchangeable
Any period	\$10million	\$10million

### 3.6. Two Way Pricing

Two way pricing is not a general market convention.

### 3.7. Quotation and Dealing

*Dealing* - As repurchase and reverse repurchase agreements are negotiated transactions, when dealing directly with other dealers, each dealer is responsible for agreeing to the terms and conditions. It is up to each dealer to make clear to the corresponding counterparty those terms and conditions. It is expected that when an offer/bid is made by one party, the other party should either deal or counter with a bid/offer.

*Overnight* -Today against the next business day.

*Tomorrow* - The following business day.

*Tomorrow/next day (T/N)*- The first leg of the “repo” settles T+1 and unwinds T+2.

*Spot* - Two business days from today. (T+2)

*Corporate* - Three business days from today. (T+3)

*Bid/buy/borrow* - Where the collateral is borrowed and the cash is lent.

*Offer/sell/lend* - Where the collateral is lent and the cash is borrowed.

### **3.8. Other Instrument Conventions**

Unless otherwise bilaterally agreed, the following conventions govern GC transactions:

- The accepted bonds/securities lodged as GC must have a longer maturity date than the term repo.
- No right of substitution exists for repos of one week or less to maturity.
- The cut-off time for substituting lines pledged as part of term GC trades is 9:30am on the business day preceding substitution.
- Rights of substitution shall be limited to once per week per individual repo.
- Rights of substitution do not carry over/accumulate from week to week. If a right of substitution is not used within any week it is lost.  
For example, for a one month trade with no rights of substitution having been exercised by the seller of the collateral within the first two weeks there are only two rights of substitution left in the trade.
- One right of substitution is one ticket of the original trade.  
For example, for a \$100m one month trade for which the seller of the collateral chooses to break it into 4 parcels of \$25m consisting of 4 different securities, the one right of substitution per week convention allows the seller to substitute only one parcel of \$25m per week, not all four.
- When a right of substitution of collateral is exercised by the seller of that collateral, the seller should match the original cash value of the existing trade.
- Notional amounts cannot be split while exercising a right of substitution without the permission of the buyer of collateral.  
For example, for a \$100m 1 month trade where the seller chooses to lend 1 security of \$100m, to satisfy a substitution request, the seller needs to replace the collateral with another parcel of \$100m. The seller cannot substitute two parcels of \$50m of different or the same collateral without the buyer's permission.
- Upon the exclusion of any collateral from the RBA's approved list those securities will then cease to trade in the GC repo market. For any outstanding GC trades, the buyer has the right to ask the seller to substitute that collateral.
- For any GC trade dealt through a broker, it is the broker's responsibility to help mediate and keep track of the substitution process during the lifetime of the trade.

### **3.8.1. Margining**

It is default practice in the Australian Repo market to make margin calls, settled via either the transfer of cash or securities, in preference to repricing transactions to cover exposures between the parties. Refer [Repo Margining Guidelines](#)

### **3.9. Basis**

All rates are quoted on an actual/365 day basis, using a simple interest calculation payable at maturity.

### **3.10. Maturity Conventions**

At call/open specific collateral repos are automatically rolled at 9:30am on the business day preceding maturity (trade date -1 basis) unless otherwise advised by either counterparty on the business day preceding maturity. Market standard is to notify prior to 9:30am all trade terminations T+1.

GC open repos are automatically rolled at 11:00am unless otherwise advised by either counterparty.

Term repos are to be collateralised with eligible securities that have a maturity date beyond the maturity date of that particular term repo.

### **3.11. Settlement Rate or Index**

Not applicable.

### **3.12. Premium Payment Date(s)**

Not applicable.

### **3.13. Expiry Conventions**

Not applicable.

### **3.14. Broker Conventions**

3.14.1 For standard repo transaction size dealt via broker screen dealing systems please refer to *Section 3.5*.

3.14.2 All prices are subject to credit;

3.14.3 All screen prices are valid until removed or refreshed;

3.14.4 Divergence from the size of the screen bid/offer (see section 3.5) is at the discretion of the screen quoted counterparty;

3.14.5 If a broker has a price on screen and a dealer asks if the bid or offer can deal for a certain size the dealer is obliged to deal that size if it is available from the dealer making the bid/offer;

3.14.6 To encourage price making, and to enhance market transparency, when dealing through a broker a dealer must be best bid/offer when inquiring whether the offer/bid will deal off screen between the bid/offer;

3.14.7 All trades conducted via the brokers are to be reported and posted within a reasonable time.





### 3.15. Confidentiality

Refer to the [AFMA Code of Conduct](#).

### 3.16. Credit

All deals subject to individual limits.

#### *Over cover (haircut)*

This is the amount by which the market value of the repo'd bonds/securities exceeds the cash amount of the transaction. The extent of over cover will vary depending on the size of the transaction, the term of the repo, the quality and maturity of the collateral and the creditworthiness of the counterparty. No standard haircut exists and this is agreed bilaterally.

### 3.17. Exercise of Options

Not applicable.

### 3.18. Pricing Formulae

3.18.1 The first leg consideration or start consideration is calculated in accordance with the RBA pricing formulae.

3.18.2 The second leg consideration or unwind consideration is calculated by using the simple interest formula with the start consideration as the principal which is multiplied by the repo rate for the number of days.

#### ***RBA pricing formulae***

Australian government bonds are priced using a formula incorporating the principles of yield to maturity and compound interest. Even though interest amounts (coupons) are paid throughout, the pricing technique present values all cash flows on a compounding basis using an effective semi-annual yield, or nominal annual yield paid semi-annually.

1) Basic bond formula:

$$P = v^{f/a} [g(1 + a_{\overline{n}|}) + 100v^n]$$

2) Ex-interest formula:

$$P = v^{f/a} (ga_{\overline{n}|} + 100v^n)$$

- 3) Near maturing bonds (specifically those entitling a purchaser to only the final coupon payment and repayment of principal). When a bond goes ex-interest for the second last time (i.e. six months plus seven days before maturity) it is treated as a special case. This formula applies until the record date for the final interest period:

$$P = \frac{100 + g}{1 + \left(\frac{f}{365}\right)i}$$

- 4) Near-maturity bonds (from the record date for the final coupon):

$$P = \frac{100}{1 + \left(\frac{f}{365}\right)i}$$

If the maturity falls on a weekend or other non-business day the proceeds date (i.e. the next business day) is used in the calculation of  $f$ .

$P$  = the price per \$100 face value, **rounded to 3 decimal places for 1) and 2) and not rounded for 3) and 4)**

$$v = \frac{1}{1 + i}$$

where  $100i$  = the half-yearly yield (per cent) to maturity in formulae 1) and 2) or the annual yield (per cent) to maturity in formula 3)

$f$  = the number of days from the date of settlement to the next interest-payment date in formula 1) and 2) or to the maturity date in formula 3)

$d$  = the number of days in the half year ending on the next interest-payment date

$g$  = the half-yearly rate of coupon payment per \$100 face value

$n$  = the term in half years from the next interest-payment date to maturity

The settlement amount will be rounded to the nearest cent (0.50 cents being rounded up).

### **Simple interest formula**

The general form for calculating the simple interest amount is:

$$I = P \times r \times t$$

where:

$I$  = amount of interest

$P$  = principle amount or present value

$r$  = rate of interest per annum

$t$  = time in years

### **3.19. Data Source**

Not applicable

### **3.20. AOFM Securities Lending Facility**

Eligible parties are able to borrow Treasury Bonds & Index Bonds through a facility provided by Australian Office of Financial Management (AOFM) settled through the RBA. Collateral provided must meet the RBA criterion for General collateral as prescribed for its repurchase agreements. The margin is currently calculated as the minimum of 300bps and 25 bps below the RBA cash rate target

Refer to <http://aofm.gov.au/commonwealth-government-securities/securities-facility/>

### **3.21. State Government Securities Lending Facilities**

Similar to that offered by AOFM and subject to applicable fees, securities lending facilities operated by a number of the State Government borrowing authorities (NSWTC, TVC, QTC, SAFA, WATC) are available to panel members.

### **3.22. RBA Regular Scheduled Board Meeting**

On regular scheduled RBA board meeting days (first Tuesday of the month except January or as otherwise determined by RBA) all trades dealt for T+1 are automatically dealt subject to spread to RBA rate (RBA27) unless bilaterally agreed.

### **3.23. RBA Out-of-Cycle Board Meeting**

In the event that RBA announces an out-of-cycle change to the official cash rate:

- On-the-day (OTD) repos are assumed to have been dealt subject to a spread to the RBA official cash rate and should reflect the cash rate target published as at 9.30am
- Open dated/at call repos should reflect the new cash rate on a T+1 basis
- Term repos (including T/N trades) should remain as previously negotiated
- All trades previously negotiated on a spread to cash basis will be reset on the date of a change to the official cash rate and should reflect the cash rate target published as at 9.30am.

### **3.24. Specific Market Behaviours**

#### **3.24.1. Access to and use of AOFM and State Government Securities Lending Facilities**

3.24.1.1 All parties dealing on-screen and via brokers are expected to have access to the AOFM and State Government facilities (as described in 3.20 and 3.21 of the Repo Conventions) either directly or under a bilateral agreement with an eligible party to access these facilities.

3.24.1.2 Market best practice requires that a party dealing on-screen and via brokers will either directly access these facilities or engage an eligible party on its behalf to access these facilities whenever it is apparent that its settlement obligation is compromised in any way, and that settlement failure is likely.

### 3.25. Collateral Management Services

Subject to bilateral agreement, the Repo Committee recommends that the following collateral schedule and haircut guidelines be applied

Schedule	Haircut
Tier 1 - AFMA GC1, however excl. t/notes, linkers	RBA Schedule
Tier 2- Current tier 1 in brokers, incl. t/notes, linkers	RBA Schedule
Tier 3- RBA basket –open market operations	RBA Schedule

## 4. Confirmations

It is market practice to send Confirmations by an electronic communication system that assists efficient and reliable processing of transactions as the preferred method over other forms of written communication such as email (subject to applicable law and bilateral agreement).

Parties should refer to [Australian Dollar Debt Instrument Confirmation & Settlement Standards for more specific information](#).

### 4.1. Obligation of Dealers

All dealers are subject to the [AFMA Code of Conduct](#).

Price discrepancies should be discussed and corrected by 2:30pm wherever possible. If a settlement failure is imminent. In the event of settlement failure it is the obligation of the failing entity to exercise due diligence to settle the transaction and source securities via {a} the market or {b} AOFM securities lending facility (refer Section 3.20) or {c} via State Government Securities Lending Facilities (refer Section 3.21) where possible.

### 4.2. Documentation

Currently The 2000 TBMA/ISMA Global Master Repurchase Agreement, with the AFMA recommended replacement of Annex 1 (available by subscription to the AFMA Guide to Australian OTC Transactions section 2.2), is the recommended market standard. This is currently being reviewed and will be replaced by the 2011 GMRA and annexes.

## 5. Settlements

Refer to [Australian Dollar Debt Instrument Confirmation & Settlement Standards](#).

## **5.1. Physical Settlements**

Physically delivered settlements are still used although infrequently. They are not the preferred form of settlement due to the high risk of failures. The RBA and the semi authorities provide a registry that tracks the flow of physical settlements.

## **5.2. Cash Settlements**

EXICO / Austraclear is the settlement system used for the settlement of all securities.

## **5.3. Forward Settlements**

For forward settlement of GC repo transactions it is the obligation of the seller to inform the buyer of collateral details by no later than 9:30am AEST on the day of settlement.

## **5.4. Settlement Failures**

Failure to settle risks the reputation of the organisation and may bring the market into disrepute. Partial settlement is to be encouraged, however the counterparty retains the discretion to accept or reject a partial settlement.

It is the obligation of the seller to immediately inform the buyer of any circumstance which threatens the settlement process (11:00am or as soon as known) so that the buyer, in the event the seller subsequently cannot deliver, can endeavour to cover the short position in the underlying security or make alternative arrangements that are agreeable to both counterparties. In the event of difficulties that arise towards end of day (after 3:00pm AEST) both counterparties must make all reasonable efforts to arrange alternatives.

It is the obligation of the failing party to exercise due diligence to settle. If the failing party is offered bonds/securities to cover a fail then it is obliged to cover the fail by borrowing the offered bonds/securities.

Dealers are expected at all times to be aware of the supply characteristics of any particular line of bonds/securities, and particularly be aware if a line is in short supply. If the repo rate on a particular line of bonds/securities falls, this is an indication of illiquidity and dealers should ensure that they have adequate bonds/securities available for future settlements. Dealers should not repo bonds/securities unless they believe that they can deliver those bonds/securities at settlement.

## **5.5. Settlement Failure Compensation Claims**

When a buyer /seller fails to match a seller/buyer's instructions or cannot settle for reasons such as lack of cash or failure to settle in Austraclear, the buyer/seller is entitled to claim use of funds at the market rate, together with any other associated costs.

When settlement failure occurs, the deal will settle on the following business day with no rate adjustment (original settlement price). If settlement continues to fail the settlement price does not alter except in circumstances where there is bilateral agreement.

In the event of cost being incurred do to a failed settlement, the party being failed should formalise a claim detailing all costs incurred and basis of claim. All such claims must be formally acknowledged and responded to within 7 business days of receipt of a claim letter.

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