



Debt Capital Market Conventions

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1. Description

Debt is an important source of funding for the maintenance and growth of businesses and governments. Debt instruments represent a financial commitment by the borrower. Typically debt instruments pay interest at set intervals and return the face value to the holder at maturity. Debt securities rank ahead of equity and may vary in seniority.

Domestic and international capital markets are an important source of long and short term funding for public borrowers. Major corporations can also take advantage of their credit ratings by accessing the international capital markets.

Participants in the debt capital market cover a wide spectrum. Major participants include banks, investment banks, brokers, governments and government agencies, other institutions and clients, and international investors including central banks and funds managers (including hedge funds).

Liquidity is determined by supply and demand. End investors influence liquidity through demand for securities. Investors purchase securities through intermediaries, usually banks or investment banks. These intermediaries hold inventory for sales and trading purposes and also in certain instances for regulatory capital purposes. Trading occurs through market making activities and broker screens.

2. Products

2.1. Domestic Commercial Paper (CP)

Commercial paper (CP), also known as promissory notes (PN), is an unconditional order to pay a fixed amount (face value) on the due date. CP is issued in bearer form at a discount and is drawn in accordance with the Bills of Exchange Act. CP is issued from 2 to 364 days (1 day less than a year). CP may be issued through a dealer panel by either competitive or unsolicited bidding. Paper is normally denominated in face value amounts of AUD\$500,000 and AUD\$1,000,000.

Paper is lodged with and settled through Austraclear. The paper stands solely on its credit rating. Investors will use the credit rating in the investment choice. CP is issued by credit worthy corporations. The majority of paper issued is in the A1+ to A1 short term credit rating range, but some A2 and A3 short term rated paper is issued.

Electronic promissory notes (EPN) are debt obligations of an issuer created by contract, as evidenced through the Austraclear regulations (see Reg 8B.5) and take the form of electronic promissory notes in the Austraclear discount security system. Rights under the Austraclear regulations are only enforceable against members and not against non member third parties, which is why only Austraclear members can issue or trade in EPN.

Non paper securities such as EPN must have a face value of at least AUD\$500,000 (refer paragraph (e) of the definition of 'debenture' under section 9 of the Corporations Law).

Registered short term notes (RSTN) also give contractual rights but are not dependent on Austraclear membership so they have a broader application if non Austraclear note holders are involved. The notes take the form of entries on a register and are debt obligations which are constituted by a deed poll. As with EPN, RSTN must have a face value of at least AUD\$500,000. Otherwise the trading characteristics of both EPN and RSTN is no different to that of CP as described above.

2.2. Floating Rate Notes (FRN)

Floating rate notes (FRN) do not have fixed coupon payments, but have a fixed coupon margin set off a floating rate index. The payments are reset at specific intervals, typically on a quarterly basis. The coupon is expressed as a margin either above or below a specific short term reference rate, eg Libor for those issued in a foreign currency or BBSW if issued in Australian Dollars. Some mortgage backed securities (MBS) can be considered FRN and are generally reset every month.

2.3. Capital Indexed Bonds (CIB)

Capital indexed bonds (CIB) feature quarterly indexation of the outstanding capital or principal value, which is repaid in full at maturity. The indexation factor is usually based on the rate of consumer price inflation represented by the Australian Bureau of Statistics' CPI, although other price and wage indices are used. A coupon interest rate on the bond is set at issue. Interest payments will vary over time in line with the indexed capital or principal value.

CIB provide the investor with inflation protection. Nominal bond returns are subject to erosion from inflation. CIB returns are linked to the inflation rate to ensure that the real return expected by the investor over the life of the bond is maintained.

2.4. Inflation Indexed Annuities

An inflation indexed annuity is a stream of regular payments that are adjusted with reference to the inflation rate to protect the real value of the payments from being eroded over time. The relevant inflation index is almost always the one quarter lagging CPI.

2.5. Interest Indexed Bonds (IIB)

An interest indexed bond is structured so that the interest payments have a fixed rate component (coupon payment) and a floating component which is added to the fixed coupon payment. The latter varies with the indexation adjustment which is usually the inflation rate. The principal is repayable at maturity at the original face value. The market for these bonds has been very limited in Australia.

2.6. Medium Term Notes (MTN)

Medium term notes (MTN) are debt obligations of an issuer, and according to the notes issued, may rank pari-passu with other senior debt or may be subordinate to senior debt. The bonds are

constituted by a deed poll and take the form of entries on a register, eg. domestic corporate bond market.

MTN are issued in a series. Each series may comprise one or more tranches issued on different dates. These subsequent series may be fungible with earlier series, but fungibility is not guaranteed. MTN may be issued depending upon documentation as a number of different instruments as allowed under its documentation or program. Typical issue characteristics are either floating or fixed, eg. subordinated debt.

2.7. Asset Backed Securities

Asset backed securities are supported by defined assets such as credit receivables which are usually held by way of a trust arrangement. Obligations to investors are met solely by the defined assets and resultant cash flow. An example of an asset backed security is a mortgage backed security (MBS) or collateralised debt obligations (CDO).

Asset backed securities may also be backed by credit cards, car loans, commercial loans and consumer loans or a portfolio of debt obligators in the case of a CDO.

2.8. Mortgage Backed Securities (MBS)

Mortgage backed securities (MBS) is a generic name for any bond or other style security issued by a mortgage provider and credit supported by pools of mortgages or specified mortgages. In Australia MBS are generally structured as FRN, reflecting the rate basis and prepayment options of the underlying mortgages.

2.9. Subordinated Debt

A debt facility that ranks behind all other forms of debt in terms of security, but ranks ahead of equity. In the event of the failure of the issuer, subordinated debt holders would not receive any payment until all legally defined creditors, including unsubordinated debt holders, are repaid in full (ie. they rank behind holders of unsecured notes). There may be various repayment rankings within the subordinated debt category (eg. senior and junior subordinated debt).

2.10. Convertible Bonds and Warrants

Convertible debt instruments are debt instruments which contain embedded options. The holder has the right to exchange the bond for equity in the issuing company at certain dates in the future according to a determined ratio. Most convertibles are callable, enabling the issuer to repurchase the outstanding bonds at a certain price and date. Once the bonds have been called the holder may choose to convert prior to repurchase by the issuer. The call allows the issuer to repurchase the bonds at an earlier date. A convertible can be thought of a bond plus an equity call. Warrants contain an option for the holder to convert the bond and receive the redemption proceeds in another form. In equity related convertible debt, the owner has the option to convert the bond into equity of the issuer at a predetermined price and time. Warrants may be issued with a bond, from which they can be detached and exercised or traded separately from the bond. Alternatively, the warrants may be issued separately. Warrants are essentially call options on the stock of a specific

corporation that provides the holder with the right to purchase other specified securities at a specified price on or by a specified date or within a specified period.

2.11. Debentures and Unsecured Notes

A debenture is a document evidencing an acknowledgment of a debt which a company has created for the purposes of raising capital. Debentures are issued by companies in return for medium and long term investment of funds by lenders.

The debenture provides that the borrower must pay to the holder a regular stream of interest payments during the term of the facility and receive the face value on the loan at the maturity of the contract. Debentures are secured by a charge over the issuing company's unpledged assets and/or specified revenues. Unsecured note refers to loans made on an unsecured basis. Debentures and unsecured notes are usually transferable.

2.12. Euro Commercial Paper (ECP)

Euro commercial paper (ECP) is an unsecured short term promise to repay a fixed amount on a certain future date offered outside a borrower's country of domicile. ECP is issued in bearer form at a discount. ECP generally is offered off a program. A dealer group, which is responsible for the marketing of each tranche, is selected. Some programs allow reverse inquiry. Issues normally are 364 days or less to maturity. ECP investors are ratings driven and therefore normally only well rated companies can access the ECP market.

2.13. Eurobonds

Bonds issued into the international market. The lead managers prepare the bond issue, set the final conditions of the bond, and select the underwriters and selling groups. Eurobonds pay a fixed rate of interest that is set at the time of issue (zero coupon eurobonds are also available). Coupons are generally paid annually in arrears. Maturities usually range from 3 to 10 years, but some high quality government agencies have issued longer. Most issues are structured with a bullet repayment.

3. Dealing

3.1. Methods of Dealing

The main methods of dealing within the debt capital markets consist of:

- Directly with clients via the telephone
- Directly with other market professionals via the telephone
- Through the broker screen market
- Electronically via Bloomberg and telephone confirmed

- Other electronic intermediary such as the internet

3.2. Electronic Dealing

May occur through interbank web sites, but all deals must be confirmed by telephone.

3.3. Business Days

3.3.1. 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.

That said Australian OTC Markets generally tend to operate in a reduced capacity on gazetted NSW public holidays that are not similarly gazette in Victoria.

3.3.2. 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.

3.4. Standard Transaction Size (market parcel)

Generally, minimum market parcels vary with specific products and issues. Minimum parcels and denominations should always be confirmed prior to dealing. Some common denominations include:

Security	Common Denomination
Inflation indexed annuities	Generally AUD\$100,000
Mortgage backed securities	AUD\$500,000 to AUD\$1,000,000+
Floating rate notes	
Corporate bonds	

3.5. Two Way Pricing

The corporate market convention is for participants to declare their intentions either to buy or sell.

3.6. Quotation and Dealing

The government and semi government debt securities market are yield driven, however these securities are often quoted as a spread to futures (EFP) or in the case of semi government a spread over the government benchmark. Corporate paper is normally quoted as a spread over a government benchmark security. Most major broker screens require participants to switch between the corporate paper and benchmark bond. That is the buyer of the corporate will buy the corporate security and sell the trader the benchmark bond.

The corporate bond market (except for securitised debt) is yield driven domestically, however overseas participants may be driven by price alone.

FRN and CP are commonly quoted as a spread to Swap/BBSW.

Securitised debt (eg. MBS) are generally quoted as a discount margin to give a price. Certain inputs are required to compute a yield to maturity or effective earning rate of the securities. Prices need to be checked between dealers.

Near maturity bonds, specifically those entitling a purchaser to only the final coupon payment and repayment of principal, are priced as discount securities.

3.7. Other Instrument Conventions

3.7.1. Bond Fungibility

New issues can be brought to the market that are fungible with currently available issues. Details should be checked first as even though bond characteristics may appear similar the bond may in fact not be fungible.

3.7.2. Closed Book and Ex-Interest Periods

It is a recommendation of the AFMA Debt Capital Markets Committee, that:

- the ex-interest period of all AUD non government bonds issued in the Australian Capital Markets be standardised to a market convention; and
- the market convention be subject to:
 - a full 7 calendar day ex-interest period for all AUD non government bonds issued in the Australian Capital Markets (ie. the close book period begins at the close of register on the 8th calendar day prior to the coupon payment date); and
 - a full 12 calendar day ex-interest period for AUD non government bonds issued in the Australian Capital Markets by issuers or guarantors who are subject to US tax laws and which give rise to US interest withholding tax (IWT) obligations. (ie. the close book period begins at the close of the register on the 13th calendar day prior to the coupon payment date).

3.7.3. Benchmark for Corporate Bonds using CGS

Why a Benchmark?

In the Australian corporate bond market liquid commonwealth government securities (CGS) are used to define the credit yield spreads which apply to the various corporate bonds outstanding, and by either adding or subtracting this credit yield spread to the CGS benchmark an investor can identify the inherent fixed income risk characteristics which attach to the corporate bond itself.

While other yield benchmarks exist (eg. the interest rate swap curve or the 3 year and 10 year futures) it is the physical CGS curve that overwhelmingly presents the most often quoted/reliable investment indicator for identifying corporate bonds when transacting.

If a corporate bond has the same maturity date as the CGS it allows dealers to simply add the spread to the government benchmark. Where the corporate bond has a different maturity date to its CGS benchmark (ie. mismatch or gap) the gap can represent an unintended or inadvertent bet.

3.8. Basis

All fixed rate securities are quoted on an actual, 365 day fixed basis. The standard convention denominator doesn't adjust for leap years unless otherwise stated.

The price of the fixed rate securities is calculated using the RBA tender stock method formula.

3.9. Maturity Conventions in Relevant Market

For floating rate instruments it can be either the following business day or modified following business day.

For fixed rate securities it is the following business day.

3.10. Settlement Rate or Index

Floating rate securities are set against BBSW. Indexed securities are generally set with reference to the lagging CPI.

3.11. Premium Payment Date(s)

OTC - by negotiation.

3.12. Expiry Conventions

Not applicable.

3.13. Broker/Trading Conventions

In this market traders act as principal.

There are no specific broker conventions.

3.14. Confidentiality

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

3.15. Credit

The ability to deal is subject to available settlement delivery limits and credit limits for the particular securities. Dealers should advise up front to the counterparty if they are unable to deal due to credit constraints.

3.16. Exercise of Options

There will usually be a defined notice period and procedure prior to the calling of an issue that can be at the borrowers or investors option.

3.17. Data Source

Weekly revaluations of corporate bond rates are displayed on *AFMAdata* page AFMA Corporate Bond Reference Rates.

Commonwealth inflation indexed bonds are displayed daily on Reuters page RBA30.

3.18. Pricing Formulae

3.18.1. Debenture or Unsecured Note

$$P = [FV(1 + i)^{-n}] + (C \times A_n^i)$$

P = price of the debenture or unsecured note

FV = face value of the security

i = current interest rate for the period expressed as a decimal

n = number of periods in which cash flows occur

C = periodic coupon payment amount

$$A_n^i = \frac{1 - (1 + i)^{-n}}{i}$$

3.18.2. Capital Indexed Bonds

$$P = V^{f/d} [g(Z + A_n^i) + 100v^n] \cdot \frac{K_t \left(1 + \frac{p}{100}\right)^{-f/d}}{100}$$

$K_t = K_{t-1} \left(1 + \frac{p}{100}\right)$ rounded to two decimal places = nominal value of the principal at the next interest payment date (whether or not there is an interest payment due)

K_{t-1} = nominal value of the principal at the previous interest payment date. K_{t-1} is equal to \$100 (the face value of the stock) at the interest payment date on or prior to the earliest date on which the stock may be settled at their first issue

i = real yield

$p = \frac{100}{2} \times \left(\frac{CPI_t}{CPI_{t-2}} - 1\right)$ = the average percentage change in the consumer price index (CPI) over the two quarters ending in the quarter which is two quarters prior to that in which the next interest payment falls (eg. if the next interest payment is in November, p is based on the average movement in the CPI over the two quarters ended in the June quarter preceding)

f = the number of days from the date of settlement to the next interest payment date

d = the number of days in the quarter ending on the next interest payment date

g = the fixed quarterly coupon rate payable (equal to the annual fixed rate divided by 4)

n = the number of full quarters between the next interest payment date and the date of maturity

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

$Z = 1$ if there is an annuity payment to the purchaser at the next annuity payment date (cum interest), or 0 if there is no payment to the purchaser at the next annuity payment date (ex interest)

The settlement amount will be rounded to the nearest cent (0.50 cent being rounded up). Interest payments for stock shall be calculated on the basis of the following formula and rounded to the nearest cent (0.50 cent being rounded up).

$$g \times \frac{K_t}{100}$$

3.18.3. Inflation Index Annuities

Annuity Payments

Payable quarterly in arrears in accordance with the following formula:

$$B_T = B_0 \times \frac{CPI_T}{CPI_0}$$

B_T = annuity payment at time T

B_0 = base annuity payment

CPI_0 = CPI index for the full calendar quarter prior to issue date

CPI_T = highest CPI index inclusive from CPI_0 to the full calendar quarter preceding the annuity payment date

Settlement Formula

$$P = \left(\frac{v}{q}\right)^{f/d} \times B_{T-1} \times q \times (Z + A_n^i)$$

B_{T-1} = previous annuity payment (or B_0 , prior to first annuity payment)

q = quarterly inflation factor = CPI_j/CPI_{j-1} (but not less than 1)

CPI_j = highest CPI index released inclusive from CPI_0 to the settlement date, inclusive

CPI_{j-1} = highest CPI index inclusive from CPI_{-1} to the second latest released CPI index (inclusive) as at the settlement date

$$A_n^i = \frac{1 - (1+i)^{-n}}{i}$$

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

i = settlement real yield (divided by 4) and expressed as a decimal

n = number of full quarters from next annuity payment to maturity

f = number of days from settlement date to next annuity payment date

d = number of days in the full quarter ending on the next annuity payment date

Z = 1 if there is an annuity payment to the purchaser at the next annuity payment date (cum interest) or 0 if there is no payment to the purchaser at the next annuity payment date (ex interest)

When the next annuity payment is known the formula becomes (cum interest):

$$P = \left(\frac{v}{q}\right)^{f/d} \times B_T \times A_n^i$$

When settlement takes place on an annuity payment date the formula becomes (ex interest):

$$P = B_T \times A_n^i$$

B_T = current annuity payment

n = number of full quarters to maturity

q as a Factor Convention

q is used in the settlement formula for calculating the next quarterly coupon adjustment and prior to the relevant CPI release the market convention is that q is based on the previous inflation adjustment. If there is significant inflation volatility an alternative value of q may be agreed for transactional purposes, or a pricing adjustment may be agreed to take place upon the CPI release by recalculating the settlement price using the actual inflation adjustment. For either

of these alternatives to apply, they must be agreed by both buyer and settler at the time of trade, otherwise the existing market convention will apply.

That is, if transactions take place before, or on, the CPI release date (but prior to the actual release time), where the settlement date is on or after the CPI release date, then the q factor is determined by the old CPI data unless otherwise agreed.

Market Conventions for Number of Decimal Places		
	<i>Capital Indexed Bonds</i>	<i>Inflation Indexed Annuity</i>
Price per \$100	3 ¹	3
V	9	9
Q	n/a	9
I	9	9
A_n^i	9	9
c	9	9
g	9	9
P	2	9
K_t	2	9
K_{t-1}	2	n/a
Base annuity	n/a	6 ²
Latest annuity	n/a	6

¹ RBA rounds to nearest cents for tenders.

² Recommendation for future issues. Some existing issues have a different rounding which is detailed in their specific information memoranda. It is not proposed to change the rounding methods of issues already in the market.

3.18.4. Floating Rate Notes

$$P = \frac{Z(b + IM) \times \frac{d}{365} + \left(\frac{IM - TM}{k}\right) A_n^i + 1}{1 + (r + TM) \times \frac{f}{365}} \times 100$$

P = price per \$100 per face value

Z = 1 if there is an annuity payment to the purchaser at the next annuity payment date, 0 if there is no payment to the purchaser at the next annuity payment date

b = the floating benchmark rate from last interest reset date to next interest rate date

d = number of days in current interest period

IM = interest margin (as a percentage) paid in addition or deduction from the floating benchmark

TM = trading margin (as a percentage) paid in addition to the floating benchmark

r = the floating benchmark rate to the next interest rate reset date

f = number of days from pricing/settlement to next interest payment date

$$A_n^i = \frac{1 - (1 + i)^{-n}}{i}$$

$$i = \frac{s + TM}{k}$$

k = payment frequency of FRN (eg. 2 = semi-annual, 4 = quarterly)

s = yield from settlement to the maturity of the FRN (with frequency k)

n = number of complete interest periods to maturity as at the next interest payment date

Market participants are under no obligation to use the benchmark rates referred to above if the market has moved since the benchmarks were set.

When the floating reference rate being used is the BBSW rate, b and r should be the average figure quoted on Reuters BBSW to two decimal places. s should be the rate quoted on Reuters page IRSW10AM, ensuring rates used are of similar frequency (or converted) to the FRN, then straight line interpolated to the maturity date if necessary, then rounded to two decimal places. The FRN price should be calculated to three decimal places.

Interpolation

- Dates for BBSW and IRSW10AM are based on the modified following business day basis.
- Actual next interest payment date and maturity date are used.
- When interpolating r , BBSW is supplemented by the RBA target cash rate (RBA30) with a date of the next business day.
- IRSW10AM rates 4 years and over need to be converted from half yearly to quarterly rests (assuming quarterly frequency on FRN).
- When interpolating s , IRSW10AM rates are supplemented by the 1 to 6 month BBSW rates converted to quarterly rests.
- Linear interpolation is used unless otherwise stated and agreed.

4. Confirmations

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

4.1. Timing

As a minimum, all trades entered into must be bilaterally confirmed, either electronically or in writing, by both parties on the day that the transaction was executed. Ideally, it is recommended that all trades entered into be confirmed, either electronically or in writing, by both parties within one hour of the trade being agreed and finalised.

Where the instrument traded requires two or more counterparties parties to agree a cash settlement price, particularly when traded via a screen broker, then the cash price should ideally be agreed within one hour directly with counterparty(s) in writing or electronically or via the screen broker.

4.2. Obligations of Dealers

Dealers should ensure that dealing tickets are produced in a timely fashion to allow for compliance with *Section 4.1*.

4.3. Documentation

For secondary markets, various issue specific documentation is available, including information memorandum, pricing supplements and original deal issue documentation.

For primary markets please refer to the [Recommendations for Australian Wholesale Debt Capital Markets Documentation](#).

5. Settlements

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

Prices are based on information available on the day the deal is struck. No adjustment is made for changes occurring between deal date and settlement date.

5.1. Physical Settlements

Settlement dates on debt securities are open to negotiation, however the following times are standard.

Security	Settlement Period
Corporate bonds with <6 months to maturity	Same day settlement
Corporate bonds with >6 months to maturity	T + 3
Indexed bonds	T + 3
Mortgages backed securities	T + 3
Eurobonds	T + 3

Settlement procedures for onshore/onshore AUD fixed interest securities are covered under the [Australian Dollar Debt Instrument Confirmation & Settlement Standards](#).

Settlement procedures for other securities are negotiated at the time of dealing. Generally settlement procedures for all non domestic AUD securities (ie. Euromarket) follow those for Eurobonds. Settlement for Eurobonds is T+5 and via Euroclear or Clearstream.

5.2. Cash Settlements

Not applicable.

5.3. Premium Payments

Not applicable.

5.4. Exercise of Options

Not applicable.

5.5. Settlements Failures

If failed settlement occurs the deal will settle on the following business day with no rate adjustment, i.e. at the original agreed settlement price. If settlement continues to fail the settlement price does not alter unless the two parties agree. This is in fact a penalty to the defaulting party as one days interest is accrued to the buyer.

Dealers should be aware if a particular line of stock is in short supply. If the repo rate on a particular line falls this is an indication of illiquidity and dealers should ensure that they have stock available for future settlements. Dealers should not sell stock if they believe that they cannot deliver that stock at settlement.

5.6. Coupon Payments

For conventions on closed book and ex-interest periods in relation to coupon payments, see *Section 3.7.2*.

6. Glossary

- Single Monthly Mortality (SMM) - Proportion of the monthly balance outstanding at the beginning of the month that repays during that month.
- Constant Prepayment Rate (CPR) - Annualised SMM.
- Weighted Average Life (WAL) - The average time that a dollar of principal remains outstanding.
- Weighted Average Maturity (WAM) - Average of the remaining terms of the underlying loans, weighted by the outstanding loan balances.
- Seasoning - Average age, since inception, of the underlying loans, weighted by the outstanding loan balances.
- Bond Factor - Proportion of the original principal balance outstanding as at the factor date.
- Call Date - The date (or dates) on which a tranche or whole issue may be called by the issuer.
- Call Amount - Percentage of outstanding collateral that will allow the issuer to call the issue.

- Step-up - The basis point increase in coupon at and after non-exercise of the call on the call date(s).