AFMA

Guidance Note: Re-referencing/Rebasing of the Australian Headline CPI

The AFMA Inflation Products Committee provides the following guidance with respect to the re-referencing/rebasing of the Australian Headline CPI. Whilst not legally binding, adherence to them by market participants will facilitate a smooth transition to incorporation of the new series, in particular through commonality of calculation methodologies.

These recommendations are subject to the documentation applying to individual transactions.

Background

- The Australian Bureau of Statistics will re-reference the Headline CPI "Weighted Average of Eight Capital Cities: All-Groups Index" to 100 for the financial year 2011/12. This re-referencing will be published with the release of the Q3 2012 CPI on 24 October 2012.

- The Old Index (reference base 1989/90) will no longer be published, and the New Index (reference base 2011/12) will be produced going forward. A back history for the New Index will be calculated and published to 1 decimal place. There will be rounding differences between the returns of the Old Index and the back history of the New Index.

- These differences do not constitute a revision.

Capital Indexed Bonds (CIBs)

- Issuers of CIBs should use the Old Index for the pricing of p/j and K_t up to the coupon date following 24 October 2012. The p/j and hence K_t for the following coupon period should be based off the New Index. This is consistent with the approach being taken by the Australian Office of Financial Management and NSW Treasury Corporation.

Indexed Annuity Bonds (IABs)

- Issuers of IABs should immediately use the New Index once it is available. Hence the payment at the next coupon date following 24 October 2012 (B_t) will be based on B_o x CPI_t/CPI_o, where B_o is unchanged, but both CPI_t and CPI_o are based on the New Index. This is consistent with the TCV Indexed Annuity bonds.

Inflation Swaps

- For deals which have a separate definition of "CPI" in the confirmation (i.e. do not reference the *ISDA Inflation Derivative Definitions*), the Calculation Agent must follow the relevant confirmation/documentation.

- Where confirmed under the 2005, 2006 or 2008 *ISDA Inflation Derivatives Definitions*, it is recommended that the Calculation Agent follows the relevant section on rebasing contained in the ISDA Definitions, as follows:

> The *2008 ISDA Inflation Derivatives Definitions* cover rebasing at 2.3
>
> "***Rebasing of the Index****. If the Calculation Agent determines that the Index has been or will be rebased at any time, the Index as so rebased (the "Rebased Index") will be used for purposes of determining the level of an Index from the date of such rebasing; provided, however, that the Calculation Agent shall make such adjustments as are made by the calculation agent pursuant to the terms and conditions of the Related Bond, if any, to the levels of the Rebased Index so that the Rebased Index levels reflect the same rate of inflation as the Index before it was rebased. If there is no Related Bond, the Calculation Agent shall make adjustments to the levels of the Rebased Index so that the Rebased Index levels reflect the same rate of inflation as the Index before it was rebased. Any such rebasing shall not affect any prior payments made under an Index Transaction.*"[1]

- This section is interpreted that for a cash flow with a base index prior to June 2012, but final index after June 2012, the Old Index is used up June 2012, and the Rebased Index from June 2012 forwards.

- Existing inflation swap trades under the ISDA Definitions do not necessarily need to be reconfirmed.

Inflation swap example under ISDA Inflation Derivative Definitions:

\$100m 5 year Zero Coupon Swap, Maturity 15/9/2016, Base CPI (CPI_o) = June 2011, Final CPI (CPI_t) = June 2016. No "related bond" specified.

Prior to re-referencing, the payment due on 15/9/2016 was \$100m x CPI_t/CPI_o, with CPI_t and CPI_o based on the Old Index

After re-referencing, the payment due on 15/9/2016 is \$100m x $CPI'_t/CPI'_z \times CPI_z/CPI_o$, with CPI'_t and CPI'_z based on the New Index, and CPI_z, CPI_o based on the Old Index. CPI'_z and CPI_z are the relevant Index values for June 2012.

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