

Bank Bills

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1. What are Bank Bills?

A **Bank Accepted Bill** (or Bank Bill as it is commonly known), is a Bill of Exchange. As defined by the Bills of Exchange Act 1909, a Bill of Exchange is:

"An unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person or to bearer".

More simply, a Bank Bill is a promise by the borrower to:

- pay the amount specified on the Bank Bill (also known as the Face Value of the Bank Bill and represents the principal and interest amount)
- pay at the date specified on the Bank Bill (referred to as the Due Date or Maturity Date)
- pay the payee specified on the Bank Bill (end holder of the Bank Bill)

In reality most bills are retained in safe custody by ANZ or traded via Austraclear, a centralised system for larger transactions. Borrowers sign a Power of Attorney relating to the specific Bank Bill facility only. This enables the Bank to sign on the borrower's behalf when the bills are printed.

The Bank (as acceptor of the Bill) accepts the responsibility for payment of the specified amount to the ultimate holder of the Bank Bill. The ultimate holder (payee) may not be the one named on the Bank Bill, as Bank Bills can be transferred by **endorsement**. This simply means

that the name of the new payee will appear on the back of the Bank Bill, signed by the holder.

2. Features of Bank Bills

Bank Bills are a flexible and popular form of finance/investment due to several factors:

Term:

- Bank Bills can be used to borrow/invest for terms ranging from 7 days to 15 years. Terms longer than 185 days are referred to as Fixed Rate Facilities or Maximum Rate Facilities and have rollovers (interest payment periods) of 185 days or shorter.

Rate:

- *Floating (or Variable) Rate Bills* can be drawn down (or bought) with maturities ranging from 7 to 185 days. When the Bank Bills mature, and are rolled over for a further term, the interest rate is reset at the rate applicable for the next term of the Bank Bills. Borrowing rates are usually based off the BBSY rate which is an independently determined and published money market buy rate for Bank Bill parcels over \$10 million.

- Alternatively, you can choose to lock in/protect your interest rate on your Bank Bill facility by using the Bank's *Fixed Rate Bill Facility* or *Maximum Rate Bill Facility*. Terms of 1-15 years are available subject to credit approval. Both these facilities are explained in more detail in section 6.

Another form of interest rate protection available to Bank Bill borrowers/investors is the *Swaps* and *Options* market. These products are completely separate from your funding facility

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and therefore any future decision on your underlying borrowing will not affect your interest rate risk profile and vice versa. *Swaps* enable borrowers to lock in the interest rate on your debt with the capability to be structured according to your cash flow requirements. *Options* enable a borrower to set a maximum interest rate payable while taking advantage of lower rates.

Both Swaps and Options are priced off the Bank Bill market and therefore can provide an effective hedge to a Bank Bill borrowing. Your ANZ Relationship Manager or ANZ Market Representative is happy to provide you with more information about these products on request.

Amount:

- Bank Bill borrowers have the flexibility to drawdown any amount within their limit at each rollover or interest payment period. This also applies to Fixed Rate Facilities and Maximum Rate Facilities as long as your individual requirements are specified at the time of the rate quotation.

Timing:

- Bank Bill borrowers/investors also have the ability to lock in the floating or fixed rate on a Bank Bill required at a future date. *Forward Start* Bank Bills or *Forward Start* Fixed Rate Facilities or *Forward Start* Maximum Rate Facilities are a contract to borrow (or invest) at a certain interest rate, from a certain date in the future. For example, should you have a funding requirement in say 90 days time, but wish to have a known budgeted cost of funds for this funding, you could take out a *Forward Bank Bill* at a negotiated rate to commence in 90 days time.

3. Borrowing via Bank Bills

The most popular way of providing Bank Bill finance to borrowers is in the form of a *Commercial Bill Acceptance Discount Facility (CBAD)*. The Bank Bills are drawn down for an agreed amount, an agreed term and a quoted rate of interest.

The borrower then receives the funds at a discount to the face value of the Bank Bill on the drawdown date, and agrees to repay the full amount on the due date. The full amount represents the original amount borrowed plus the interest owed. The formula used to calculate the discounted proceeds is explained in more detail in Example 1.

A Commercial Bill Acceptance Discount Facility involves:

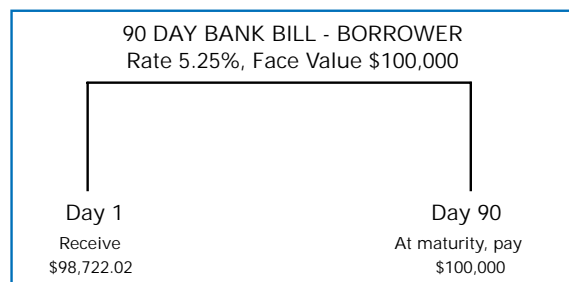
- **Accepting** - Bank Bills drawn by a customer on the Bank and accepted by the Bank, such that the Bank agrees to pay the face value of the Bank Bill to the holder on the due date; and
- **Discounting** - The process whereby Bank Bills are signed and exchanged for the discounted proceeds. For convenience, customers typically provide the Bank with a power of attorney to sign the Bank Bills on their behalf.

Bank fees associated with Bank Bill Facilities must be discussed with your ANZ Relationship Manager and have not been included in the following example.

Example 1:

To finance your working capital requirements, you borrow via Bank Bills (sometimes referred to as a drawdown of Bank Bills to the Bank) with a face value of \$100,000 for a period of 90 days. ANZ quotes you a rate of 5.25%. As per the formula below, on day 1 you receive the discounted amount of \$98,722.02. In 90 days time, you repay \$100,000 to the Bank, for a total interest charge of \$1,277.98.

This is the same as saying \$98,722.02 has been borrowed for 90 days at 5.25%.



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The discounted amount is calculated as follows:

$$\begin{aligned}
 \text{Discounted Amount} &= \frac{\text{Face Value} \times 36500}{(\text{Yield Rate} \times \text{Term}) + 36500} \\
 &= \frac{100,000 \times 36500}{(5.25 \times 90) + 36500} \\
 &= \$98,722.02
 \end{aligned}$$

Further explanation on this formula can be found in section 7.

Once a Bank Bill has been discounted, it is then possible for the holder of the Bank Bill (the Bank in Example 1) to sell the Bank Bill to an investor prior to maturity.

4. Investing in Bank Bills

Bank Bills are not only used for borrowing purposes - they are also available for investment purposes, with attractive features such as liquidity, flexibility, security and competitive rates of return.

By virtue of the Bills of Exchange Act, the Bank undertakes to pay on presentation of the Bank Accepted Bill, irrespective of the repayment ability of the drawer.

Investors can buy Bank Bills from the Bank, for an agreed face value, an agreed term and a quoted rate of interest. The Bank Bills are then endorsed by the Bank to acknowledge the change in ownership, transferring ownership to the buyer. A contingent liability remains with each individual endorser until the Bank Bill matures and is paid out.

Once again, the Bank Bills are discount instruments, so the investor purchases the bills for an amount that is at a discount to the actual face value of the Bank Bills.

Upon maturity, the Bank will pay you the full face value of the Bank Bills, which includes the initial purchase price and the interest receivable. You then have the option of reinvesting in Bank Bills at the prevailing interest rate, retrieving the funds, or entering some other form of investment.

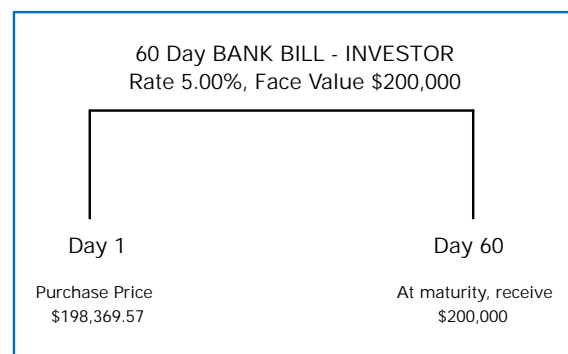
Please note that Bank fees associated to Bank Bill borrowing facilities do not apply to Bank Bill investments. In addition, amounts greater than \$50,000 are exempt from Financial Institutions Duty (FID).

An additional feature of investing in Bank Accepted Bills is that should you require funds before the due date, the Bank will purchase the Bank Bills from you at the prevailing interest rate. This purchase price will be determined by the current market rate for the term remaining to maturity. This means that, should it be necessary, you can access your funds at short notice.

Example 2:

You are an investor with surplus funds to invest for 60 days and you have been quoted an interest rate of 5.00% by ANZ. On day 1 you invest \$198,369.57 representing the discounted amount of the face value of the Bank Bill purchased (calculated using the yield formula referred to in Example 1).

In 60 days time, you will receive \$200,000 (the face value, which comprises both principal and interest). This equates to interest received of \$1,630.43.



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5. Managing Your Interest Rate Exposure

The majority of loans or investments expose you to some type of interest rate risk. However, there are ANZ products to help you minimise this risk as part of an overall interest rate risk management strategy.

The fundamental steps in interest rate exposure management are as follows:-

- Identify and quantify your existing interest rate exposures.
- List all of your interest rate exposures to help clearly identify them. This allows a weighted average cost of funds/average rate of return to be easily determined.
- Ascertain sensitivity to interest rate movements.

Determining how far you should pursue interest rate exposure management depends partially on how sensitive your assets and/or liabilities are to movements in interest rates. This sensitivity can be calculated in terms of the impact that movements in interest rates may have on funding costs (or rate of return), anticipated profitability and the business environment.

However, when quantifying this impact on your debt or investment portfolio, it is important to remember that whether fixed or floating, you may be exposed to adverse interest rate movements. Any floating rate debt (such as Bank Bills) is exposed to interest rates rising and a subsequent increase in funding costs, while any investments in floating rate securities are subject to falls in interest rates.

Conversely, any fixed rate debt is sensitive to a fall in interest rates as advantage can not be taken of the lower interest rate environment. The same problem exists with any fixed rate investments, as you are unable to take advantage of any increase in interest rates.

6. Interest Rate Risk Management Instruments

Fixed Rate Facilities

A Fixed Rate Facility (FRF) offers a fixed rate of interest for borrowings for a term that can range between 1 and 15 years, subject to credit approval. It represents an agreement which locks in a fixed rate of interest for debt via Bank Bills, which usually rollover every 90 days (alternative interest payment cycles are available). FRFs operate in a similar fashion to Bank Bills, except that at each rollover of the Bank Bills, the interest rate remains the same until maturity date, as agreed at the outset of the borrowing.

The minimum amount for an FRF is \$100,000. By entering into an FRF, you are provided with a known interest rate for your debt which can assist you in your budgeting process.

Should you wish to cancel an FRF, the Bank will calculate a payout figure based on current market rates. This may result in you receiving a payment if market rates have moved higher, or making a payment to the Bank if interest rates have moved lower. The Bank requires two days notice prior to the next rollover date to accommodate a cancellation request.

Variations of Fixed Rate Facilities are also available to suit particular requirements; ie:

- A Forward Start FRF enables a company to set a rate now for an FRF to commence at a specified time in the future; and
- An Amortising/Accreting FRF makes allowance for reductions or increases in principal over the FRF period.
- A similar facility known as a Fixed Rate Investment is available to investors.

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Maximum Rate Facility

A Maximum Rate Facility (MRF) combines the flexibility of floating interest rates with the protection of a Fixed Rate Facility. This flexibility cannot be achieved with an FRF, as the FRF locks in a specific rate irrespective of interest rate movements.

In the case of a borrower, an MRF permits the purchaser to take advantage of any fall in Bank Bill rates, while locking in an agreed maximum interest rate. That is, the borrower is able to “cap” (limit) the maximum interest rate payable on all or part of the Bank Bill facility.

In return for this protection, an MRF fee (or premium as in an insurance policy) is payable. The MRF fee can be paid in one installment up-front, or amortised over the term of the facility.

The minimum amount for the MRF is \$100,000. You can protect your borrowings for periods of up to 15 years, subject to credit approval.

As with the Fixed Rate Facility, should you decide to terminate the MRF prior to its maturity, the Bank is able to accommodate such a request with two working days notice prior to the next rollover date. Whilst cancellation of an MRF does not attract a penalty, some form of cash settlement will usually be necessary to complete the prepayment if the fee is being paid over the life of the facility.

If the premium was paid up-front, recalculation of the premium using current rates, the remaining term, and current volatility will be necessary to determine how much, if any, of the MRF fee is rebateable.

A similar product for investments is available. This product places a ‘**floor**’ (or lower limit) on the interest rate that your investments will earn, according to the interest rate you set when you entered the agreement.

Please note that the above list is not exhaustive, and that the descriptions have been summarised. For detailed information on interest rate risk management products, please call your nearest ANZ Markets Representative.

7. Bank Bill Formula

The Bank Bill formula as illustrated in Section 3 is a form of ‘**Present Valuing**’. That is, for a Bank Bill with a face value of \$100,000 for 90 days at an interest rate of 5.25%, the amount borrowed (or invested) is not \$100,000. This is because the \$100,000 is the amount you pay back (as a borrower) or receive (as an investor) at the maturity date - ie: day 90. The \$100,000 represents both the principal borrowed and the interest to be paid on maturity.

The Bank Bill formula is as follows:

$$\text{Discounted Amount} = \frac{\text{Face Value} \times 36500}{(\text{Yield Rate} \times \text{Term}) + 36500}$$

Using the Bank Bill Formula, you would receive \$98,722.02 as a borrower (or pay as an investor) on day 1.

This can be seen, as follows:

$$\begin{aligned} \$98,722.02 \times 5.25\% \text{ for } 90 \text{ days} &= \$1,277.98 \text{ (interest).} \\ \$98,722.02 + \$1,277.98 &= \$100,000 \\ \text{Principal} + \text{Interest} &= \text{Face Value} \end{aligned}$$

The 5.25% is a Yield Rate and is demonstrated below.

$$\frac{\$1,277.98}{\$98,722.02} \times \frac{365}{90} = 5.25\%$$

8. ANZ Contacts

For more information on Bank Bills or other ANZ Markets products, please contact your nearest ANZ Markets Representative or Relationship Manager.

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