



The last hurdle cleared for ETFs

Today brings local investors news of a market makeover

ANDREW MAIN
WEALTH EDITOR

AUSTRALIA is now less than a month away from initiating a fully functioning market in fixed-interest exchange-traded funds, thanks to a makeover being announced today of the all-important ASX rules governing how ETFs are backed and priced.

It's one thing to have an equity or bullion ETF backed by tangible collateral such as stock or physical metal, but quite another to back an ETF trading on a minute-by-minute basis if there's no way to guarantee that the bonds the ETF is based on are not being correctly priced on a matching basis.

Otherwise the fixed-interest ETF market would be almost permanently open to arbitrage and mispricing.

That's one reason why ASX Ltd has altered what are called the AQUA rules, which until now had been set in such a way that a fixed-interest ETF could not permissibly have been listed. Effectively, the rules simply didn't have anything about debt products being allowed, so they weren't.

It's not yet clear how the rules have been changed in such a way as to safeguard investors at the same time as making the ETFs tradeable.

But the amended rules identify two specific bond indices, the well-established UBS Composite

Bond Index and the newly established S&P/ASX Australian Fixed Interest Index, announced in October, as being suitable to have ETFs measured against. *The Australian* understands that because there are now two indices following bond prices as closely as possible, the risk of mispricing during minute-by-minute trading has been reduced.

ASX spokesman Richard Murphy said yesterday that "we're aiming for the first week of March" as a lunch date for fixed interest ETFs, with three issuers planning to launch a spread of 10 different ETFs over what he called "a very wide range of underlying debt securities".

It used to be possible in Australia to buy Commonwealth Bonds, but in more recent decades the only fixed-interest options available in the listed market have been hybrids and convertible notes, which has proved a major

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impediment in moving investors' asset allocation away from an over-reliance on equities.

It is an uncomfortable fact that while most savers in sophisticated economies have about 25 per cent of their portfolio invested in vari-

ous forms of fixed-interest, the number here is only just over half that amount at 14 per cent.

Given that the federal government is sufficiently proud of its very low debt, we won't be looking for government bond issuance to rectify the shortage of scrip around, but there are many other forms of high-grade corporate bond whose issuers would love to see a more liquid market in their paper, and ETF issuance can help.

Until fixed-interest ETFs start listing, the only way for most Australian investors to get a slice of a government bond is to apply to organisations such as FIIG that buy \$250,000 chunks of government bonds and break them down into \$50,000 face-value parcels.

The new S&P index uses bond pricing provided by YieldBroker, which in turn collects bond pricing information from multiple dealers.

The result should be that bonds will be marked to market in a way that will reflect how bonds transact in their existing over-the-counter (unlisted) market.

ASX is understood to have been consulting with consumer watchdog ASIC for more than two years and the final collaboration needed the ratification of Treasury before the rules could be formally changed.