



BANK OF ENGLAND

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Sterling Risk-Free Rate Working Group
Francois Jourdain (Chair)
Barclays
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06 December 2016

Dear Francois,

The Sterling Risk Free Rate (RFR) Working Group has now been meeting for over 18 months, and I am very grateful to you and members of the Group for your continued support and commitment to this important work.

Significant progress has been made during that time. Thanks to your collective efforts we have a number of credible candidate Risk Free Rates available, and a clear sight of the issues that bear on the choice between them.

That does not mean the Group faces a straightforward choice – and my understanding is that there is not yet a consensus on the Group as to whether to recommend reformed SONIA or a secured benchmark as the sterling RFR.

I also know that a key area of uncertainty for the Group is around how and whether a transition of the OIS market to a secured rate could be achieved. For some of you that uncertainty stands in the way of making a decision.

In this context I thought it might be helpful for the Bank of England to reiterate our objectives for the process, and provide some guidance on our expectations of the timeframes for the process from here.

As you know the Bank initiated the RFR WG in March 2015 to follow up on the recommendations of the July 2014 FSB report 'Reforming Major Interest Rate Benchmarks'.

The ultimate objective of the Group is to develop a robust alternative to sterling Libor, and to catalyse a change in market practice so that a significant portion of derivatives contracts reference the new RFR rather than Libor. That is because the over-reliance of derivatives markets on Libor represents an unnecessary vulnerability for the financial system.

I believe – as I said at the Group’s first meeting – that this change needs to be a market-driven process. That is most likely to lead to the best outcome for the market, and will help to ensure the support necessary to aggregate liquidity in a single RFR.

From the Bank’s perspective, it is most important that you reach a decision that is implementable – that can deliver against the objective of the Group to drive change in the derivatives market. And, in view of the financial stability risks around the continuing dominance of Libor, it is also important that a decision is reached relatively soon so that adoption can begin on a reasonable timeframe.

The original timeline for the Group’s work envisaged that adoption of an RFR as an alternative to Libor would begin at the start of 2016. For very good reasons – including the need to allow time for candidate RFRs to emerge – this has not proven possible. However the passage of time has only sharpened the need for robust alternatives for Libor.

Having taken your advice as Chair of the Group, might I suggest a timeframe for the RFR decision that I think strikes an appropriate balance between the Group’s need to gather additional information to inform its recommendation, and the need to reach a resolution and switch focus to adoption.

Given that a key impediment to the Group reaching a clear decision at this point is uncertainty over a prospective OIS transition, I suggest that the Group spends a further relatively short period of time – perhaps three months – working on its OIS transition plan.¹ I recognise that it is important to fully explore transition options in order to give the Group a real choice between a secured RFR and reformed SONIA, and the Bank would therefore be supportive of an OIS transition plan that would plausibly succeed over, say, a 2-3 year timeframe – including by using its convening power if appropriate to help coordinate support for a transition.

The objective of further work on OIS transition should therefore be to determine whether an augmented transition plan could be executed, with a high chance of success, over the next two to three years. My starting point is that any transition should be voluntary. That suggests any resulting redistribution (as a result of changes in NPV) would need to be minimal, or dealt with in a way that is accepted as reasonable by the vast majority of affected market participants. And of course it is important that the transition should not compromise firms’ risk management (through market dislocation), or the Bank’s supervisory objectives in respect of CCPs.

I do not underestimate the difficulty of this task. It will require significant work to formulate and establish the viability of an improved OIS transition plan. Any resulting plan will require significant effort and commitment on the part of members’ firms, as well as end-users, if it is to succeed. Accordingly, as the Group has identified, an important part of the work is likely to be getting input from end users as to whether they would support and commit to the proposed transition.

¹ It is worth noting that a short delay to the RFR decision has the advantage that the final specification of reformed SONIA – incorporating the Bank’s response to any feedback received in its current consultation – will be available, and that FTSE Russell will likely have launched their new SONET gilt repo benchmark.

I hope that after three months the Group would be able to reach an RFR recommendation. That means – if a feasible transition path to a secured rate can be found – a decision between a secured rate and reformed SONIA.

However, there must be a reasonable chance that a feasible transition path to a secured rate cannot be identified. It would be helpful to know whether, if that were the case, the Group would be likely to coalesce around reformed SONIA as the only deliverable option.

I hope this letter provides some helpful clarity on the Bank's objectives. I will place a copy of it on the Working Group's web page. Let me again thank you and Working Group members for your continued valuable participation in this important initiative.

Regards,

A handwritten signature in black ink that reads "Chris Salmon". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.

Chris Salmon
Executive Director, Markets

cc Sterling Risk Free Rate Working Group members