The Working Group on Sterling Risk-Free Reference Rates

Speech by Tushar Morzaria, Chair, Working Group on Sterling Risk-Free Reference Rates and Barclays Group CFO

5 June 2019

It is an honour and a privilege to have accepted the Bank of England and FCA's invitation last year to assume the role of Chair of the Working Group on Sterling Risk-Free Reference Rates.

As Dave described, the objective of the Working Group is to work with market participants to catalyse a transition to use the Sterling Overnight Interbank Average Rate (SONIA) as the primary interest rate benchmark in sterling markets.

To this end, the Working Group has already achieved some significant milestones, but there are many challenges ahead. So I would like to begin by sharing with you what the Working Group has identified as our key focus areas at this time. I will then make a few remarks on how the Working Group and other stakeholders can help to address these challenges.

Key challenges

One of our first actions this year was to assess how we could build on the Working Group's important achievements thus far, and to identify the actions we would need to execute to deliver a successful transition to SONIA. In particular, what steps would be required to help embed SONIA in the sterling derivatives and cash markets. Where can we identify obstacles to transition and what can we do to unblock them, to increase the use of SONIA. With that in mind, we have developed a high level roadmap to lay out some of the key steps and target outcomes, which you will able to find on Bank of England's website page dedicated to the Working Group.

In the end, our engagement with stakeholders across a variety of asset classes highlighted three core areas requiring attention: term rate, accounting treatments and regulatory dependencies. These became our immediate priorities.

Term Rate

As we have heard, liquidity in SONIA referencing markets is increasing, but unfortunately not uniformly across products. There has been robust discussion regarding the need for a SONIA-based term rate, and whether such a term rate could facilitate transition away from LIBOR. For example, one of the challenges we hear from some cash market participants is how to replace a three-month LIBOR rate with an overnight SONIA rate.

The Working Group conducted some extensive analysis on this question last year, culminating in the Term SONIA Reference Rate consultation (TSRR) which is available on the Bank's website. The consultation concluded that a TSRR would facilitate transition for some cash market participants where usage of forward-looking rates has historically been common, such as in the loans markets. I say some participants because we anticipate corporate borrowers will increasingly prefer to reference compounded SONIA and we encourage users of both cash and derivatives products to press ahead on that basis.

SONIA adoption has proceeded rapidly over the past year, across a wider range of products than some market participants initially expected, not only in derivatives, but also in floating rate notes and securitisations. The Working Group encourages this use. And to be sure, the Working Group expects the future use of any forward-looking risk-free term rate in cash markets to be more limited than the current use of LIBOR.

Nonetheless, the Working Group concluded a term rate could help to reduce reliance on LIBOR. Last month we published a statement outlining our commitment to supporting development of a SONIA-based term rate. This is also available on the Bank's website.

In response to the Working Group's Expression of Interest, three credible administrators presented their approaches to developing a SONIA-based term rate: ICE Benchmark Administration, FTSE-Russell, and Refinitiv. The Working Group will continue to support and engage in this work as appropriate, and we expect to be able to communicate progress on this front later in the year.

Accounting Treatments

Another area where the Working Group has listened to the views of market participants is hedge accounting. In particular, there have been questions raised regarding how will transition affect these beneficial relationships. For example, does the cessation of LIBOR mean some hedge accounting treatment may no longer be permitted?

The International Accounting Standards Board (IASB) has been looking closely at such financial reporting matters for some time. In March, the Working Group wrote the IASB to support their efforts and share some of the issues identified by our Accounting Task Force. Last month the IASB published a consultation on some of these points, which I encourage you to read. Our expectation is the IASB will implement very welcomed relief from next January.

Regulatory Dependencies

Our third priority area for 2019 is to examine some of the regulatory issues on the minds of market participants looking to transition. That is to say, to try and identify some of the laws or regulations that currently exist which perhaps did not contemplate the transition from LIBOR to new risk-free rates. Such laws may inadvertently hinder or fragment the broad-based adoption of risk free rates more generally.

The Working Group agreed to set up a dedicated Task Force to consider these implications, and I am grateful to the FCA for volunteering to Chair this effort - the involvement of the Official Sector shows they are taking this issue seriously.

I am also very grateful to the constructive input from members of the Task Force; they represent a broad cross section of UK industry. Their input has been invaluable and will enable the Working Group to write to relevant regulators highlighting regulatory issues and requesting their removal. For example, some of issues identified so far are as diverse as EU mandated discount curves, domestic capital model approvals and grandfathering of legacy swaps under global margin rules. It is quite apparent the work here has implications outside the UK.

And reflecting on that international angle, our work on regulatory dependencies feeds directly into a sub group of the Official Sector Steering Group (OSSG), which is looking at the same issues from a global perspective. This is very welcomed, and in a moment Andrew will speak about some of the work in which the OSSG is currently engaged.

Senior Advisory Group

The achievements of the Working Group thus far make me optimistic. Our effort benefits greatly from the dedicated and energetic people representing corporates, asset managers, banks, infrastructure providers and trade associations. Thank you for your commitment to the Working Group.

This depth of membership gives me confidence in the Working Group's ability to identify and address key issues. To ensure visibility and support for the transition across senior peers in UK, we have reached out to senior leaders to form an advisory group. The aim of this group is to support, not replace the good work being done by the broader Working Group, to help add momentum to drive the transition effort with the end of 2021 only two-and-a-half years away.

In particular, this senior group will help to set strategic direction on transition work, deploy resource and influence within their own institutions to maintain momentum and consider international co-ordination and co-operation beyond sterling markets where relevant, given the challenges for many firms are broader than one currency. We all met for the first time this morning, with Dave and Andrew, and I am pleased to announce this group is committed to our common purpose. I personally want to thank them again for their engagement in and support of this important work.

Conclusion

To conclude, transition to SONIA is crucial for the financial stability of the sterling markets. Adoption is well underway, and this is very encouraging but challenges remain. The Working Group can provide tools for transition, but all market participants must use them. It is our collective responsibility to take the necessary steps to achieve a comprehensive and orderly transition.

Thank you.