Minutes of the Meeting of the Working Group on Sterling Risk-Free Reference Rates

Wednesday 2 September

Bank of England

Minutes of 14 July 2015 meeting

1 The Minutes of the previous meeting on 14 July were approved.

Update from individual workstreams

<u>Sub-group for secured rates</u>

2 Following the discussion at the 14 July meeting, the sub-group had continued to assess data sources and calculation methodologies for the production of a secured benchmark. They also had begun to consider how a transition for the overnight index swap (OIS) market from unsecured (i.e. SONIA) to a secured rate could be achieved. This work was in its early stages.

<u>Sub-group for unsecured rates</u>

3 The sub-group noted the Bank's recent consultation paper, "A new sterling money market data collection and the reform of SONIA"[1], and were awaiting additional information from the Bank regarding its plans for producing SONIA.

<u>End-user outreach</u>

4 The first stage of the reference rate end-user outreach had been completed. Feedback from discussions conducted since the last Working Group meeting was provided in a short summary.

<u>Contract robustness</u>

5 The sub-group were working on best practice guidelines for a scenario where a reference rate became unavailable or unviable, exploring how a shift to use an alternative rate could be achieved. The group were focusing on broad actions under such a scenario: 1) what actions the benchmark administrator would need to take; 2) what actions users of the benchmark would need to take; and 3) what role there is for a third party – such as the regulatory authorities – for example if the administrator became insolvent.

6 The group had also considered the introduction of "trigger events" for determining whether a reference rate was unviable (e.g. underlying volumes fall consistently below a set level), but felt such a step would be too prescriptive. Next steps were to develop these initial actions and then establish how these arrangements could be integrated into contract documentation.

Update from the US Alternative Reference Rate Committee (ARRC)[2]

7 Sandie O'Connor, Chair of the ARRC, gave an update to the Working Group on progress in the US's risk-free rate (RFR) initiative. The first stage of the ARRC's work had been to identify candidate risk-free rates, which were durable, reliable and compliant with the IOSCO Principles for Financial Benchmarks.

[1] http://www.bankofengland.co.uk/markets/Documents/cpsonia0715.pdf
[2] http://www.newyorkfed.org/arrc/

Two candidates are currently being considered: 1) a secured rate – a hybrid repo rate benchmark comprised of overnight GC and triparty repo transactions; or 2) an unsecured rate – the Federal Reserve Bank of New York's proposed Overnight Bank Funding Rate (OBFR)[3]. No decision regarding these two candidates had yet been taken.

8 The ARRC had now begun to consider issues related to transition and adoption of the selected benchmark. The Working Group noted that many of the issues being considered by the ARRC were similar between the US Dollar and Sterling markets; and it was noted that consistency across currencies should be considered in making the choice of RFR. The Chairs agreed to work closely to aid greater understanding and avoid duplicative work.

Bank of England comments on data collection and sterling unsecured money markets

9 The Bank provided an update on its involvement in benchmark reform, covering its plans for money market data collection and SONIA reform, as outlined in the consultation document published on 30 July.

10 In the Bank's view it was important that robust secured and unsecured sterling benchmarks were available, to ensure the Working Group had a genuine choice to make regarding the appropriate RFR. While the Bank was actively engaged in reforming SONIA, there was scope for a secured benchmark with broad market coverage to be produced in the private sector and the Bank was supportive of plans in this area, without endorsing any particular provider.

11 The Bank then provided an overview of the drivers of activity in sterling overnight unsecured deposit market, drawing on a round of meetings conducted with the money market desks of a number of banks active in sterling markets, as well as analysis of available market data. The key points arising from the market intelligence meetings were:

a) Banks noted that the current regulatory environment made overnight deposits relatively unattractive for them;

b) Banks reported that bilateral overnight deposits were often considered in the context of a broader client relationship, for example as part of a package with term funding;

c) This was reported to have little effect on the rate paid on such deposits which depended, among other things, on bank characteristics, the size of the deposit, and depositor type;

d) More broadly it seemed there was some segmentation in the market between banks with a large sterling deposit base, and were not active bidders for funds, and other banks who were more active, for example in the brokered market; and

e) Banks active in the bilateral and brokered market reported that they offered similar rates in both markets.

12 Data collected by ICE BA from LIBOR panel banks – which had been supplied to the Bank with the permission of the data providers – provided further insight into the sterling overnight unsecured deposit market. The Bank's analysis showed that:

[3] http://www.newyorkfed.org/markets/opolicy/operating_policy_150708.html

a) Interest rates in the market were relatively tightly distributed, with around 85% by volume lying within 5bp of the volume weighted average rate;

b) While the average rate paid by individual banks varied, banks transacting significant volumes of overnight deposit business tended to pay close to the market rate and have a narrower spread of rates than less active banks; and

c) Larger trades tended to have higher and less dispersed rates.

13 The importance attached by banks to customer relationships suggested the possibility that bilateral deposits would provide a less pure measure than brokered deposits of the rate that balanced the supply and demand of funds in the market. However, it was also clear that the narrow base of transactions in the brokered market meant it might be unrepresentative of rates paid in the broader market. That suggested the potential for a trade-off to exist in broadening the base of transactions in SONIA.

14 Group members enquired as to the Bank's transition plans for including bilateral deposit data within the SONIA rate. The Bank noted that it expected to be able to provide greater detail on the rate to the Group and the market as a whole in early in the second quarter 2016, once data collection had been in place for a number of months. The Bank will work closely with key stakeholders to ensure that the transition to the enhanced methodology occurs with the minimum possible disruption.

A secured money market benchmark proposal

15 Euroclear UK and Ireland (EUI) presented to the Group their proposal for the production of a repo rate benchmark. They intend to build on the investigatory work conducted by the secured rate sub-group's data collection, by conducting a feasibility study for producing a benchmark. They will investigate: whether they have access to sufficient data in their settlement systems for producing a benchmark and the feasibility of obtaining the data needed to fill any gaps; how and whether that data could be used to produce a rate; what governance and other arrangements need to be established; and whether a commercial basis exists to allow EUI to at least break even by producing the rate.

16 The Group welcomed EUI's proposal. It was felt that other data providers may be willing to produce a repo benchmark and the Group wished to ensure a process existed for other providers to present any plans they may have.

Issues discussed related to transition

17 The Group discussed issues related to transition. In particular, the Group discussed what considerations existed for transitioning the existing sterling OIS market – which references SONIA – to a market which references a secured rate. It was noted that the OIS market was primarily an interdealer market, whereas by comparison interest rate swap (IRS) products – which reference LIBOR – were used by a larger community of investors. Therefore, it was felt that an interdealer-led transition of the OIS market might be easier to achieve than to replace LIBOR.

18 The Group also noted that the rate chosen should be the primary reference rate for OIS markets, as well as the typical rate for discounting and valuation, as well as the rate paid on collateral – in both bilateral and centrally-cleared product markets.

19 Group members noted structural differences between the US dollar and sterling IRS markets, such as investors-types – UK pension funds for example are more active in sterling markets relative to US pension funds in the US dollar markets – and the maturity profile of existing LIBOR exposures – which is typically longer in the sterling markets than for US dollars.

20 The Group also noted the potential for economic transfer when implementing a transition. For example, where a transition from one benchmark rate to another, which is at a different economic level, could entail a transfer of wealth between parties to a contract. Some members felt that it was possible that a market price could be agreed to account for any wealth transfer.

The roadmap for future meetings

21 The Chair suggested that the Group could vote to provide an indicative steer as to their preference over a secured or unsecured rate sometime in late third quarter 2015. An indicative preference would allow the Group to focus efforts on implementing a transition to one rate. However, at this stage many Group participants felt that they did not have sufficient information in order to make a fair decision.

22 Additional information was sought in a number of areas. First, greater detail on the mechanical and legal processes for implementing a secured rate, such as developing a related OIS market and establishing the subsequent curve as that used for discounting cash flows. Second, the Group felt they needed greater certainty as to how the Bank's expansion of data inputs to the production of SONIA would affect the behaviour of the rate. Third, some members felt that a detailed head-to-head comparison of the secured and unsecured rates, making use of the selection criteria agreed earlier this year, would be beneficial to any vote.

23 The Group questioned what impact there would be on the overall timetable for delaying a vote. The Bank acknowledged that such a delay would adversely affect the timetable, as originally set out by the Financial Stability Board. But the Bank noted that were the Group to place greater weight on making a choice with what the Group deemed insufficient information, postponement might be justified.

Private sector attendees

Nick Saggers	**Bank of America-Merrill Lynch**
Francois Jourdain	**Barclays (Chairman)**
Mike Manna	**Barclays**
Sahbi Jerad	**BNP Paribas**
Ludovic de Beaucorps	**BNP Paribas**
Mark Smith	**Citigroup**
Alain Verdickt	**Citigroup**
Laurent Curtat	**Credit Suisse**
John Hilty	**Deutsche Bank**
Michael Graham	**Goldman Sachs**
Christophe Rivoire	**HSBC**
Charles Bristow	**JP Morgan Chase**
Ian Fox	**Lloyds**
Ciaran O'Flynn	**Morgan Stanley**
Freddie Napier	**Morgan Stanley**
David Bradley	**Royal Bank of Scotland**
John Cummins	**Royal Bank of Scotland**
Alan Williams	**Santander UK**
Stephane Cuny	**Société Générale**
Chirag Dave	**UBS**
Lai Lai Wong	**ISDA (Observer only)**
Philip Whitehurst	**LCH.Clearnet (Observer only)**
Angus Scott	**Euroclear UK and Ireland (Guest)**
Craig Clayton	**Euroclear UK and Ireland (Guest)**
Sandie O'Connor	**Chair, US Alternative Reference Rates Committee (Guest)**

Official sector attendees

Ed Ocampo	**Bank of England**
Tim Taylor	**Bank of England**
Will Parry	**Bank of England**
Rob Harris	**Bank of England**
Ben Morley	**Bank of England**
Jan Lasik	**Bank of England**
Carlos Molinas	**Financial Conduct Authority**
Devid Mazzoneto	**Financial Conduct Authority**
Gill Ní-Bhroin	**Financial Conduct Authority**