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

Wednesday 23 September

Bank of England

Minutes of 2 September 2015 meeting

1 The Minutes of the previous meeting on 2 September were approved.

A proposal for a secured benchmark

2 Representatives from ICAP (John Edwards and Ian Chicken) and ICAP Information Services (IIS) (Jan de Smedt) presented to the Group regarding their plans to produce a new sterling benchmark as part of their suite of RepoFunds Rate indices. The sterling benchmark will use specific and general collateral repo transaction data from the BrokerTec and MTS interdealer trading platforms, although transaction data from other platforms may also be included in due course. The rate will be calculated using an iterative elimination methodology, which minimises skew created by specialness in repo transactions, and IIS are currently undertaking a back-testing exercise.

3 ISDA have already approved legal definitions for the current French, German and Italian euro-denominated Repo Funds Rate indices and ICAP is working with ISDA to get the pan-European index approved as well. ICAP is in discussions with swap dealers and central counterparties to establish a cleared OIS product, referencing the benchmarks. IIS have designed the benchmark governance processes with the forthcoming EU regulations in mind.

4 The Group welcomed IIS's initiative, noting that this, alongside EUI's proposal (presented to the 2 September meeting), would be beneficial to the secured market, regardless of the outcome of the Group's deliberations on the RFR. The Group noted that the proposed IIS benchmark provided only partial coverage of the market, with underlying volumes lower than estimates of the aggregate size of the sterling gilt repo market, although considerably higher than the existing RONIA rate.

CME Clearing: comments on sterling benchmark reform

5 Representatives from the CME outlined some considerations regarding the reform of sterling benchmarks and transition issues. They noted that, were the Group to choose reformed SONIA as the RFR, a transition from LIBOR would be relatively straightforward. But were the Group to choose a secured benchmark, an OIS product referencing that benchmark would need to be created before that product could be cleared.

6 In order to establish a product for clearing, three items are required: 1) a history of prices and volumes, to allow the central counterparty to analyse market dynamics and to set margin requirements; 2) the ability to ascertain prices in a stressed environment; and 3) default management plans, which include the ability to auction portfolios of transactions. It was estimated that it could take nine to twelve months to establish a cleared product once a rate had been chosen, dependent on how liquidity develops and CCP internal governance processes. However, it was noted that regulatory approval procedures could lengthen this estimate.

7 The Group noted that it was potentially problematic that a new product typically needs to be well-traded before it is eligible for clearing, but that dealers were unwilling to trade uncleared products, due in part to regulatory incentives. The discussion considered options that could be explored to resolve this circularity, such as the use of similar existing products to analyse market dynamics or the imposition of volume commitments for swap dealers.

8 The Group also discussed transition issues related to changes to the Price Alignment Interest (PAI) and the discounting curve used by the clearing house. CME noted that any change to PAI and discounting would require strong support from customers and would need to be driven by market practice. One suggestion was that a separate clearing portfolio could be created, which used the chosen RFR as the PAI rate and the basis for the discount curve; then after some years and a reduction in basis risk, the old portfolio could be wound down.

9 An alternative would be to encourage a natural migration, by creating a cleared RFR product discounted using the existing discount curve, where participants would naturally be pulled towards switching to an RFR discount curve and then to changing the PAI. The Group agreed that it would be important to manage any economic re-distribution resulting from the switch to an RFR as part of the transition arrangements.

Contract robustness workstream report

10 The workstream leads outlined a set of principles to be used in the event of long-term unavailability of a benchmark used in financial contracts. It was noted that where a benchmark became unavailable, or unviable, due to a reduction in underlying transaction volumes, contracts should allow flexibility for the benchmark to evolve under the direction of the administrator.

11 The leads also outlined a potential set of options where the administrator has been unable to produce an improved successor rate, such as: the role for the benchmark oversight committee in designating a successor rate; a third-party engaged by the oversight committee to designate a successor rate; or a role for the authorities in designating a successor rate.

12 One member stated the example of central counterparties, which would have the ability to unilaterally stipulate an alternative rate, were the benchmark to be unavailable. The Group noted that further work was required regarding the role of third parties and the oversight committee, before the workstream began to explore how these principles could be incorporated into financial contracts.

Update from the National Working Group for Swiss Franc Reference Rates (NWG)

13 The Co-Chairs from the NWG and its sub-group on alternative risk free rates outlined the current stage of discussions within the Group. The market for Swiss Franc term rates is small and tends to be fragmented, in some cases there were different money market curves for different market participants. As alternative risk free rates there were two existing benchmarks in the Swiss Franc money market, both of which have drawbacks.

14 One option, SARON – which is a transaction-based measure of overnight GC repo rates – needed improved governance. The second option, TOIS – which is a panel-based measure of overnight unsecured rates – also required improvements to meet all IOSCO principles.

15 The NWG is in the early stages of considering implementation and transition issues. One issue that had arisen is that, aside from the large international Swiss banks, the majority of Swiss Franc swaps are traded in London. The NWG recognises that international consistency across RFRs would foster the development of a liquid cross currency swap market.

Procedures for voting and further information

16 The Chair outlined next steps for the Group. First, he requested that all members confirm on behalf of their firms that they have appropriate internal governance processes in order to be able to participate in any votes by the Group.

17 Second, he outlined three potential decisions the Group could take and the resultant impact on its forward work-plan and timeline:

a) Select reformed SONIA as the RFR. Future work would then be dedicated to planning the transition away from LIBOR to reformed SONIA;

b) Select a secured rate for the RFR, on the basis that at least one of the proposals presented to the Group so far was likely to result in an acceptable benchmark. Future work would focus first on aiding the establishment of a robust secured benchmark and transitioning the OIS market from SONIA to that new benchmark, then on a transition away from LIBOR; or

c) Defer the RFR decision until additional information regarding both secured and unsecured benchmarks was available. In this case the Group would need to deliver contingent (but comprehensive) transition plans for both the unsecured and secured RFR options.

18 Members were asked to consider whether they were in a position to choose either option (a) or (b), or whether they felt that further information was required, as per option (c). In the latter case, members were encouraged to specify what information would enable them to make a determination in order to focus the Group's efforts if it chose to delay a decision on the RFR. One suggestion was that Group members could provide data on swap portfolios to the Bank of England, in order to compile a view as to any potential economic redistribution, especially between different counterparty-types.

Private sector attendees

Nick Saggers	**Bank of America-Merrill Lynch**
Francois Jourdain	**Barclays (Chairman)**
Mike Manna	**Barclays**
Laurent Dulout	**BNP Paribas**
Alain Verdickt	**Citigroup**
Laurent Curtat	**Credit Suisse**
Adrian Munday	**Deutsche Bank**
Nikhil Choraria	**Goldman Sachs**
Christophe Rivoire	**HSBC**
Christophe Coutte	**Lloyds**
Mike Curtis	**Nomura**
Ciaran O'Flynn	**Morgan Stanley**
Freddie Napier	**Morgan Stanley**
David Bradley	**Royal Bank of Scotland**
Toby Stevenson	**Royal Bank of Scotland**
Simon Wilson	**Royal Bank of Scotland**
Paul Barnes	**Santander UK**
Stephane Cuny	**Société Générale**
Chirag Dave	**UBS**
Paul Canty	**UBS**
David Geen	**ISDA (Observer only)**
Lai Lai Wong	**ISDA (Observer only)**
Philip Whitehurst	**LCH.Clearnet (Observer only)**
Dan Maguire	**LCH.Clearnet (Observer only)**
John Edwards	**EBS Brokertec (Guest)**
Ian Chicken	**EBS Brokertec (Guest)**
Jan de Smedt	**EBS Brokertec (Guest)**
Richard Stevens	**CME Clearing Europe (Guest)**
Udesh Jha	**CME Clearing Europe (Guest)**
Otto Huber	**Co-Chair, National Working Group for CHF Reference Rates (Guest)**
Martin Bardenhewer	**Co-Chair, National Working Group for CHF Reference Rates (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**