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

Wednesday 18 March

Bank of England

Introduction and welcome

1 Minouche Shafik welcomed attendees, and thanked them for participating in the Group.

The global context for reference rate reform

2 Martin Wheatley (Financial Conduct Authority) outlined the conclusions of the recent Financial Stability Board (FSB) report 'Reforming Major Interest Rate Benchmarks', which provided the context and motivation for the establishment of the Working Group.

3 David Bowman (Federal Reserve Board) summarised the ongoing parallel process underway in the US. The Federal Reserve Board and the Federal Reserve Bank of New York had jointly convened the Alternative Reference Rates Committee (ARRC), prompted by the FSB recommendations and the US Financial Stability Oversight Council (FSOC).

The role of the Working Group on Sterling Risk-Free Reference Rates

4 Chris Salmon outlined the objectives and structure of the Working Group, as described in its Terms of Reference.[1,2] Members were invited to comment on the Terms of Reference.

5 In the absence of comments, the Terms of Reference were approved by the Group.

Bank initial views on alternative RFRs and transition strategies

6 Bank staff outlined five potential candidate near risk-free reference rates (RFR) that had been identified by the FSB or suggested by market participants:

i. Bank of England Bank Rate;
ii. Sterling Overnight Index Average (SONIA) – a measure of overnight unsecured deposits;
iii. An overnight secured (repo) rate;
iv. A weighted average of the rate on Bank of England reserves and overnight unsecured deposits in private markets;
v. A rate constructed from term overnight index swaps (OIS).

7 The Bank noted that there were a number of issues that would need to be considered when evaluating these potential RFRs. They included the volume of transactions underpinning the rate; the sustainability of the underlying market; the extent to which market infrastructure for the rate already existed; and the likely ease of transition from Libor to a new RFR.

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[1] Chris Salmon's remarks are available on the Bank's website here: http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech811.pdf

[2] Terms of Reference available here: http://www.bankofengland.co.uk/markets/Documents/sterlingoperations/rfr/tor.pdf

8 It would also be important for the Group to consider how to ensure the robustness of financial contracts in the event of a sudden unavailability of the RFR, or potential changes in market structure, in line with the IOSCO Principles for Financial Benchmarks.

Working Group open discussion

9 There followed a wide-ranging exchange of initial views among group members, summarised here.

What importance should be placed on cross-currency coordination?

10 The Group considered the extent to which RFR choice should be coordinated across currencies. For example, would it be problematic for cross-currency basis swap markets if some RFRs were secured rates and some were unsecured? These issues would need to be thought through in detail. There was a suggestion that the Group could delay making its decision until after the US ARRC had chosen its preferred rate.

Initial discussion of the RFR options

11 The relatively low transactions volumes underpinning the SONIA benchmark were noted by the Group. In that context participants welcomed the Bank's initiative to collect data from banks to support a broader overnight unsecured benchmark – a reformed SONIA – including bilateral as well as brokered transactions. It would be important for the level and volatility of the proposed new rate to be as similar as possible to the existing rate. However, there was some residual concern about the possibility that the downward trend in unsecured volumes over recent years might continue.

12 In contrast most participants expected volumes in general collateral (GC) repo markets to be robust over the medium-term. It would be important to work through the impact of regulatory initiatives on this market. While some regulations encouraged the increased use of funding via the secured market, the role of the Leverage Ratio could be to reduce overnight repo volumes, and both the Liquidity Coverage Ratio and Net Stable Funding Ratio encouraged banks to reduce their reliance on overnight funding, and increase term funding.

13 The Working Group noted the embedded role of Bank Rate in the UK economy – for example, its use a reference rate in mortgage contracts. Choosing Bank Rate as the RFR would allow treasury desks to hedge the interest rate risk associated with such mortgages with little or no basis risk.

14 There was a brief discussion of an RFR that weighted together secured and unsecured money market rates. That would have the benefit of future-proofing the rate to potential changes in market structure. Some participants were sceptical due to the potential complexity of such a rate.

15 Regarding term OIS as a potential RFR, some noted end-user demand for a term element within the swap reference rate, so this should not be ruled out. Once a robust overnight rate has been established, with a well-developed OIS market, a term OIS fixing could be created using an aggregated central limit order book. A high volume of transactions might not be necessary if the rate were based on firm, executable quotes. The Working Group noted that this solution may form part of a second round recommendation.

Contract robustness

16 The Group discussed the role of fall-back provisions and alternative rates. Regardless of the RFR eventually selected, the alternatives could potentially be useful in a contingency scenario. It was noted that formal legal advice would be required when considering any potential changes to contracts to include more robust fall-back provisions.

Ensuring a successful transition

17 The Working Group noted that the dealer community would not itself be able to force a transition away from Libor. End-users of the reference rate would need to be convinced that the proposed RFR benefitted them directly. In addition, the liquidity of the associated market would be crucial in determining whether market participants would be willing to use that RFR.

18 The role of accounting standards was briefly discussed. The Group was clear that it was vital that the RFR (and its associated curve) was aligned with the common discount rate in Credit Support Annexes, as well as the rate used for mark-to-market and accounting purposes.

19 Finally, the Group noted that the expectation for the RFR initiative should not be for a 100% shift from Libor to the new RFR. There would be a long tail of legacy contracts referencing Libor (some with remaining maturities of 50 years or more) and we should anticipate an ongoing need to risk-manage these legacy positions with new Libor referenced contracts. There could also continue to be demand, particularly from corporates, for a reference rate which includes a term credit risk component.

Election of Chair and next steps

20 Nominations for the Chair of the Working Group were announced and Francois Jourdain was elected.

21 The Chair will develop a work plan for the Group – in coordination with Group members and the Bank – which will be discussed and agreed at the next meeting.

Private Sector Attendees

Nick Saggers	Bank of America-Merrill Lynch
Francois Jourdain	Barclays
Laurent Dulout	BNP Paribas
Mathieu Gaveau	BNP Paribas
Mark Smith	Citigroup
Alain Verdickt	Citigroup
Laurent Curtat	Credit Suisse
Adrian Munday	Deutsche Bank
Jonathan Hall	Goldman Sachs
Nirubhan Pathmanabhan	Goldman Sachs
Elie El Hayek	HSBC
Charles Bristow	JP Morgan Chase
Christophe Coutte	Lloyds
Ed McAleer	Morgan Stanley
Tom Heenan	Nomura
Lewis O'Donald	Nomura
Peter Nielsen	Royal Bank of Scotland
Paul Barnes	Santander UK
Stephane Cuny	Société Générale
Paul Canty	UBS
David Geen	ISDA (Observer only)

Official Sector Attendees

Minouche Shafik	Bank of England
Chris Salmon	Bank of England
Tim Taylor	Bank of England
Ed Ocampo	Bank of England
Martin Wheatley	Financial Conduct Authority
Carlos Molinas	Financial Conduct Authority
David Bowman	US Federal Reserve Board
Sebastien Kraenzlin	Swiss National Bank