

Minutes of the Meeting of the Working Group on Sterling Risk-Free Reference Rates
Friday 9 December 2016
Bank of England offices – Moorgate

Obligations under competition law

1 The Chairman reminded all members of the Group of their responsibilities in relation to compliance with competition law and the importance of taking their own independent competition law advice.

Minutes of previous meeting

2 The minutes of the previous meeting on 22 November were approved.

Letter from Chris Salmon

3. The Group discussed the recent letter from Chris Salmon (Executive Director for Markets, Bank of England).¹ The letter provided guidance on the Bank of England's expectations for the timeframe for the WG's recommendation, and suggested that the Group spent a further three months developing its OIS transition plan – as an effective transition plan was a prerequisite if a secured RFR were to be chosen.

4. The Chair noted that the currently proposed OIS transition plan was not thought by the Group to have a sufficiently high chance of success. Therefore, it was clear that further work would indeed be required to provide the best possible chance that a secured rate could be a viable option for consideration alongside reformed SONIA. If a transition was still seen as not feasible after further work, then reformed SONIA would be the only viable candidate RFR.

5. The Chair noted that the letter had suggested the Bank would be willing to use "its convening power if appropriate to help coordinate support for a transition". In considering an effective transition, the Chair asked the Working Group to consider what action the authorities could take. The Bank reconfirmed that it had no plans to discontinue SONIA, which had previously been suggested as a way to trigger a point-in-time transition.

Review of RFR selection criteria

6. Following the discussion of selection criteria and the review of candidate RFRs at the 22 November meeting, refinements to the selection criteria were approved.²

7. The Chair's office and the Bank presented an initial pass at 'RAG' rating the candidate RFRs against those selection criteria. The Group agreed with the proposed ratings, which would be an input into its eventual recommendation.

Open discussion and advocacy of candidate RFRs

8. Group members discussed their preferences for the RFR. Some Group members expressed a preference for reformed SONIA since it is an established rate which requires no additional OIS transition – meaning that adoption as a Libor alternative could begin immediately. Moreover, some felt the Bank's

¹ <http://www.bankofengland.co.uk/markets/Documents/sterlingoperations/rfr/2016/letter061216.pdf>

² <http://www.bankofengland.co.uk/markets/Documents/sterlingoperations/rfr/rfrselection.pdf>

proposed definition of SONIA, which allowed for evolution in the event that market functioning in the unsecured deposit market deteriorated, provided insurance against concerns about the future robustness of that market.

9. However, many Group members felt that additional work on transition would be warranted, as a secured RFR had a number of attractive features – including higher transaction volumes and a better fit to the needs of some users. It was important that the secured option was explored fully. In any case, it was thought that work on OIS transition issues would be useful for the subsequent phase of work on adoption of the RFR as a LIBOR alternative, where the issues would be similar.

10. Regarding an OIS transition plan, the Group discussed a number of topics that would need to be considered in greater detail in the coming months. In particular, the Group discussed the merits of a transition which focused only on the flow of new contracts, as opposed to a transition that also aimed to convert the stock of pre-existing swap contracts.

11. A key advantage of transitioning just the flow of OIS contracts was that it could commence at an earlier point, allowing adoption of the RFR in place of LIBOR to begin much sooner. The Group discussed some ideas in order to make such a transition successful, including the development of ‘clearing pods’ for RFR-linked derivatives, where the RFR is both the reference rate and the discount rate, and where SONIA- and LIBOR-referencing derivatives could be discounted against the RFR. Once liquidity is well established, the use of the RFR for discounting and PAI could be extended to all trades. A key disadvantage of this approach however, was that it would likely temporarily increase aggregate basis risk (between SONIA, Libor and the secured RFR), which could hamper the development of liquidity and compromise the success of the transition.

12. As a result, the majority of the Group favoured a transition approach which affected the existing stock of contracts, as well as the flow, since this could support liquidity in RFR-linked instruments and would reduce the risk of fragmentation and basis risk.

13. A key aspect to be considered in a transition affecting the stock of contracts was the potential for wealth transfer in the event that there was a basis between SONIA and the secured RFR. Therefore, in order to achieve consensus on a transition of the stock, it is likely that market participants would need to either: i) agree that the forward basis between SONIA and the RFR was likely to be negligible or not forecastable; or ii) develop some mechanism to ensure any transfers of wealth are accepted as reasonable by the vast majority of affected market participants.

14. The transition approach which was most likely to be successful was a consensual, point-in-time switchover, with a sufficient notice period. Most participants felt that this would require near-universal agreement to simultaneously change PAI, discounting rate and reference rate. A long notice period – over which the SONIA-RFR basis is less forecastable, and hence wealth transfer is not known in advance – could encourage transition.

15. Some suggested there would be a role for cash assets in driving demand for RFR-linked derivatives, for example by referencing corporate lending or securities issuance to the RFR. The Group also noted that favourable capital treatment of RFR-linked exposures could also incentivise transition.

Next steps

16. The Bank reiterated it was willing to support whichever rate the Group recommended as the RFR, provided adoption was workable on a reasonable timeframe and with minimal disruption. The Group agreed to focus on transition plans for the next three months, which would also allow further end user outreach on any transition proposals. After three months, if a feasible transition plan could be developed, the Group would choose between a secured RFR and reformed SONIA.

Private sector attendees

Nick Sagers	Bank of America-Merrill Lynch
Francois Jourdain	Barclays (Chairman)
Andreas Giannopoulos	Barclays (Chair's office)
Mike Manna	Barclays
Adrian Averre	BNP Paribas
Stephen Randall	Citigroup
Alistair Sharp	Credit Suisse
John Hilty	Deutsche Bank
Ryan Sbarra	Deutsche Bank
Michael Graham	Goldman Sachs
Nikhil Choraria	Goldman Sachs
Christophe Rivoire	HSBC
Christophe Coutte	Lloyds
Freddie Napier	Morgan Stanley
Ciaran O'Flynn	Morgan Stanley
Guy Winkworth	Morgan Stanley
Mike Curtis	Nomura
Simon Wilson	Royal Bank of Scotland
Toby Stevenson	Royal Bank of Scotland
Paul Barnes	Santander
Stephane Cuny	Société Générale
Chirag Dave	UBS

Official sector attendees

Tim Taylor	Bank of England
Will Parry	Bank of England
Rob Harris	Bank of England
Renée Horrell	Bank of England
Jan Lasik	Bank of England
Ben Morley	Bank of England
Heather Pilley	Financial Conduct Authority
Devid Mazzonetto	Financial Conduct Authority