

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

Monday 20 August 2018

Moorgate, London, EC2R 6DA

Competition law reminder

1. The Chair welcomed attendees and reminded them of their responsibilities in relation to competition law and the importance of taking their own independent advice from the legal and/or compliance teams at their respective institutions.

Minutes of the previous meeting

2. The minutes of the previous meeting were approved.

ISDA consultation¹ on fallbacks in derivative contracts

3. The FCA outlined what it considered to be the appropriate parameters for discussion on the ISDA consultation, especially the spread adjustment alternatives, given the potential risk for inside information to be inadvertently created or disclosed during any such discussions coupled with potential competition law risks. However, for the purpose of the Working Group discussions, it was noted that it would be appropriate and useful for members to make technical comments on the ISDA consultation. The FCA counselled against members in this meeting providing their firm's non-public views on any of the spread adjustment options set out in the consultation, or identifying a group consensus on a preferred spread adjustment option.
4. The Chair reiterated that each institution should ensure that it had robust governance in place in order to agree the content of responses to ISDA's consultation directly. In the subsequent discussion some members highlighted that they had the appropriate governance arrangements in place to respond to the consultation.
5. One member noted that they had formed their own view as an institution but asked whether, given their clients may have different views, they should include a representation of clients' views in their response to ISDA. The Chair mentioned that ISDA expects direct responses and that clients should be advised to directly respond to the consultation. One trade association mentioned that they may submit an industry response to reflect a wider set of views, particularly of smaller institutions who may not ordinarily respond directly.
6. One member asked about the read across to IBORs not captured by the ISDA consultation such as USD LIBOR. ISDA mentioned that their mandate was fallbacks across all IBORs and they would want to bring this work together across currencies. The decision to consult on certain currencies now was made to avoid holding up the wider work, and following a discussion with the Official Sector Steering Group. ISDA highlighted that they were interested in the extent to which market participants thought that the fallback methodologies should be aligned across all currencies.

¹ <http://assets.isda.org/media/f253b540-193/42c13663-pdf/>

7. The fallback rate proposed by ISDA is of the form of a term adjusted RFR added to a credit spread. The discussion was then split in two parts: a discussion of the term adjustment methodologies; followed by a discussion of the credit spread methodologies.

Approach to the Term Adjustment:

8. The discussion focused on different considerations that could be used by respondents to assess each proposed methodology. The considerations could be described at a high level as follows: (i) practicality of the term adjustment, (ii) its compatibility with current standards, (iii) its capacity to introduce new or exotic risks and (iv) the materiality of introduced value transfer.
9. There was discussion around whether options 1, 2 and 4 for the term adjustment in the consultation would create some risk management challenges and could be disruptive to financial markets, due to the introduction of convexity and exotic risk vis a vis the OIS market. Some members noted that Option 3 mirrors existing conventions in the OIS market, and would retain consistency with the interest accrual period of the majority of the existing LIBOR swaps. However, some market participants might struggle with this option due to operational complexities.
10. One member mentioned that the credit spread calculation could be done in such way that it mitigates some of the convexity and risk management issues, at least at the point of transition.
11. Another member noted that, in certain cash market products, creating a term adjustment based on a forward looking term rate (e.g. a term SONIA reference rate) might be preferable to the options proposed in the consultation. The FCA caveated that, in this instance, the term rate would need to be appropriately robust. It was discussed that insofar as parties would prefer not to use an ISDA protocol containing one of the proposed options within the consultation, they may opt to negotiate bilaterally to incorporate language of their choosing about fallbacks into their contracts, including the usage of a forward looking term rate.

Approach to the credit spread adjustment:

12. The Chair asked the group for their views about the role of the RFRWG in relation to the credit spread component of the consultation. The group agreed that it may be helpful to publish a set of considerations to assist market participants in assessing each of the three proposed methodologies in the ISDA consultation.
13. Some preliminary considerations were mentioned, including that the focus should be on preserving market structure and avoiding market disruption. Other suggested criteria included that the credit spread adjustment should be bound within a certain range of possibilities. It was agreed that one of the criteria should be how practical and feasible it would be to source data inputs, calculate and display the credit spread adjustment.
14. It was agreed that members should send to the RFR Secretariat their list of criteria for the credit adjustment selection. A member suggested that the criteria should be listed by order of importance. The RFR Secretariat will produce an anonymised synthesis of the criteria proposed by the RFR WG members; this list will then be examined at the next RFR WG for approval and publication.

Market Infrastructure sub-group discussion

15. The Chair introduced a representative from M&G who would be one of the co-chairs of the newly established market infrastructure Sub-Group alongside NatWest Markets. He encouraged members to notify the Secretariat of any expressions of interest in participating in the sub-group. He explained that the sub-group would establish a list of infrastructure and operational readiness issues, and seek to engage with technology and infrastructure firms via panels and roundtables to identify solutions to those issues.
16. An initial draft list of issues that had been compiled since the last RFR Working Group meeting is included as Annex 1 to these minutes. Members were encouraged to provide additional input to supplement this preliminary list.

Sub-Group updates

Syndicated loans

17. The Sub-Group agenda for its upcoming meeting in September will consider fallbacks for SONIA referencing loans, as well as draft conventions for referencing SONIA compounded over the interest period in loan agreements. The agenda will also include a presentation on the ISDA consultation. In addition, the sub-group will be discussing the development of a paper on the issues arising when lending with contracts referencing LIBOR, as well as some suggestions regarding legacy loans.

Bond markets

18. The Sub-Group continues to work on a set of preferred conventions for adoption of SONIA compounded over the interest period in bonds. The Sub-Group will be considering the differences between the SONIA-referencing European Investment Bank bond² and the SOFR-referencing Fannie Mae³ and World Bank bonds⁴. The sub-group will consider in its next meeting how conversion of legacy LIBOR-linked bonds to SONIA could be done in practice.

Pension Funds & Insurance companies

19. The Sub-Group was compiling material and reaching out to the Euro working group ahead of a potential call with EIOPA to be organised in September, where the sub-group would be presenting on the challenges posed by LIBOR transition. More broadly, the Euro working group expressed an interest in appointing a delegate to participate in the UK pensions and insurance company sub-group's upcoming meetings.
20. The Sub-Group was still working on drafting a letter to EIOPA as mentioned in the previous RFRWG meeting.

² <https://www.bourse.lu/security/XS1848770407/267839>

³ <http://www.fanniema.com/resources/file/fundmarket/pdf/PS3136G4TF0.pdf>

⁴ <https://www.worldbank.org/en/news/press-release/2018/08/14/world-bank-launches-markets-first-ssa-secured-overnight-financing-rate-sofr-bond>

Communication & Outreach

21. The Sub-Group's immediate priorities were to establish a communication and media strategy; to establish a specific targeted outreach programme to reach the pockets of the markets where there may still be limited awareness of the need to transition and to create a compilation of public education materials; and to start a quarterly newsletter. The Sub-Group chair would also be engaging with the Alternative Reference Rates Committee ("ARRC") communication sub-group.
22. It was noted that a vital element was to address a widespread lack of understanding of the key high-level messages around the transition in broader markets. The Sub-Group was asked to consider producing a pack of key facts and information to act as a "go to guide" on transition to support public advocacy efforts at senior levels. One trade association mentioned having compiled a similar informative document for emerging markets that they would share with the Sub-Group.

Cross-currency swap sub-group

23. The Chair noted that the US ARRC had convened a sub-group to consider transition issues with regard to cross-currency swaps. The Chair and Vice-Chairs of the Working Group had attended an initial meeting of the sub-group. The Working Group would discuss who would be best placed to attend regularly at its next meeting.

Approach to accounting implications of transition

24. One of the Vice-Chairs of the Working Group updated the RFR Working Group members on a recent discussion on accounting implications of transition between the Bank of England, the FCA, Shell and Barclays. No new issues additional to those noted by the ISDA accounting committee presentation at the Working Group's May meeting⁵ emerged, however it was noted for completeness that corporates operated under IFRS 9 hedge accounting rules whilst some banks were still transitioning from IAS 39 to IFRS 9.
25. The importance of reviewing hedge documentation within the 2021 transition horizon was stressed, in order to consider reflection of potential consequences of the transition.
26. The Chair and the Vice-Chair then discussed a formal approach to the IASB on how the RFR Working Group could best engage in the work they were conducting, as it was important for the IASB to take the time to conduct the relevant assessments within its current research project.
27. The Working Group agreed to send a letter to the IASB welcoming their creation of a research project on LIBOR transition, and offering to engage closely with the IASB on this topic. It was suggested that the Working Group could send a letter jointly with the Euro Working Group on Risk-Free Rates. The Chair and the Vice Chairs, with RFR Secretariat, will compile a preliminary draft.

Approach to legal risks associated with Working Group's activities

28. This agenda item was deferred to the next meeting.

AOB

⁵ <https://www.bankofengland.co.uk/-/media/boe/files/minutes/2018/rfr-may-2018.pdf?la=en&hash=79247E5FF386D6DAF0DC9B9B166832CB78F8B8FA>

29. The Chair stressed the importance of members committing resources to the transition and to the Working Group. The Communication & Outreach sub-group for example was in need of more resources if it was to accomplish its objectives. The Working Group discussed that it was important for firms to budget accordingly to provide support to the Working Group's efforts to catalyse transition.
30. The Chair thanked Ed Ocampo of the Bank of England, on behalf of the Working Group, for all his contributions in the past 5 years to support interest rate benchmark reform and the Working Group's work since its inception.

Private sector attendees

Francois Jourdain	Barclays (Chair)
Andreas Giannopoulos	Barclays (Chair's office)
Frances Hinden	Shell (Vice Chair)
Simon Wilkinson	Legal & General Investment Management (Vice Chair)
Robert De Roeck	Aberdeen Standard Investments
Sarah Boyce	Association of Corporate Treasurers
Nick Saggars	Bank of America Merrill Lynch
Doug Laurie	Barclays
Robert Mitchelson	Blackrock
Michael Barron	Deutsche Bank
Jasper Lillingston	European Bank for Reconstruction & Development
Chirag Dave (phone)	Goldman Sachs
Ed Jenkins	HSBC
Chris Rhodes (phone)	ICE Group
Paul Richards	ICMA
Robert Gall	Insight Investment
Galina Dimitrova	Investment Association
Scott O'Malia (phone)	ISDA
Anne Battle (phone)	ISDA
Clare Dawson	Loan Market Association
Philip Whitehurst	London Stock Exchange Group
Ian Fox	Lloyds Banking Group
Dave Covey	M&G Investments
Richard Merrett	Nationwide Building Society
Kwok Liu	National Grid

Official sector attendees

Andrew Hauser	Bank of England
Rhys Phillips	Bank of England
Ed Ocampo	Bank of England
Imane Bakkar	Bank of England
Josh Jones	Bank of England
Charlotte Pope-Williams	Bank of England
Edwin Schooling-Latter	Financial Conduct Authority
Harriet Hunnoble	Financial Conduct Authority
Adeshini Naidoo	Financial Conduct Authority
Heather Pilley	Financial Conduct Authority

Annex 1 – Item 4 – Market infrastructure sub-group discussion

This strawman documentation is in draft form to support the discussion around the market infrastructure sub-group, which in turns will liaise via panels and/or roundtable with technology and infrastructure firms.

NB: This is a preliminary set of issues focusing on adoption of SONIA, with adoption being one component of the transition

1. Infrastructure Information and analytics
 - a. Publication of Sonia compounded over standard interest period, as an accrual and as a final rate, on a daily basis or a calculator to calculate the rate.
 - b. Analytics on Sonia bonds, loans, repos, swaps, swaptions, cap floors, cross currency swaps, etc.
 - c. Broker screen for all Sonia products
2. Bonds processing
 - a. Ability for front office 'FO' (trading, syndication, repo, etc.) buy and sell side systems to perform calculations (incl. risk analytics) for FRN linked to Sonia
 - b. Ability for back office 'BO' (settlement), accounting and clearing systems for the buy and sell side to calculate accruals, P/L and settlement values
 - c. Ability for bonds trading platform and exchanges to accommodate Sonia FRNs.
 - d. Ability for issuers to calculate and accrue Sonia FRNs
 - e. More generally, updates to bonds systems including payment and clearing systems; treasury management systems: ALM systems; financial reporting systems; and trading platforms.
3. Loans processing
 - a. Ability for FO (trading, syndication, management) systems to calculate and risk loans linked to Sonia
 - b. Ability for BO (settlement, servicing) and accounting systems to calculate accruals, P/L and settlement values
 - c. Ability for loans trading platforms to accommodate Sonia FRNs
 - d. Ability for issuers to calculate and accrue Sonia loans
4. Derivatives processing
 - a. Ability for swap execution facilities, clearing house and confirmation utilities to deal with atypical Sonia swaps (like par par asset swaps) the same way it deals with equivalent Libor swaps).
 - b. Clearing eligibility for SONIA swaps with multi-payment (eg. 3m or 6m) frequencies (currently payments are annual, or maturity date if shorter).
 - c. Creation and ability to execute, transact etc. of all other interest rates derivatives products usually linked to Libor (Swaptions, cap/floors, etc)
 - d. Utility to perform multilateral bulk indexation change from Libor to Sonia
 - e. Utility to perform the repapering of legacy contracts indexation change
5. Treasury and Asset liability management systems
 - a. System and accounting ability to base fund transfer pricing on Sonia
 - b. System and accounting ability to manage interest rates risk in the Banking Books (IRBB) using Sonia curve and Sonia instruments.
 - c. System and accounting ability to base intercompany funding and external funding on Sonia.
6. Other
 - a. System and accounting ability to do trade finance indexed to Sonia
 - b. System and accounting ability to do retail investment products indexed to Sonia
 - c. System and reporting ability to benchmark fund performance on Sonia.