

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

Wednesday 2 July 2018

Shell Centre, London, SE1 7NA

Introduction

1. Andrew Hauser introduced himself as the Bank of England's new Executive Director for Markets and thanked the Working Group for the work done so far to promote the development of RFRs, the selection of SONIA as its preferred alternative RFR, and the initiation of the transition from sterling LIBOR. He noted that LIBOR transition was likely to be a significant challenge and was accordingly one of the highest priorities both for himself and for the Bank as a whole.

Competition law and conflicts of interest

2. 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 institution for further guidance.
3. ICE Group and London Stock Exchange Group had noted at the previous meeting that they had conflicts of interest with regard to the Term SONIA Reference Rate Consultation item as both organisations owned benchmark administrators which could potentially administer a Term SONIA Reference Rate in future. The Chair advised that they should recuse themselves from any vote on this topic.

Minutes of the previous meeting

4. The minutes of the previous meeting were approved.

Items for potential Working Group communication/publication

Term SONIA reference rates (TSRR) consultation¹

5. The TSRR Sub-Group chair introduced a revised draft of the consultation. The consultation identified relevant use cases for TSRRs, assessed the feasibility of constructing robust TSRRs, and outlined and recommended a potential methodology for their construction.
6. The consultation sought feedback on its recommendations and encouraged market participants to take forward work on the development of robust TSRRs, which the Working Group anticipates could be available in the second half of 2019.
7. Under its original terms of reference the Sub-Group was to recommend the use cases for which TSRRs may be appropriate and propose measures with the aim of avoiding systemic reliance on TSRRs. After extensive deliberations, members concluded that it would instead be advisable to seek guidance from supervisory authorities on these issues.²

¹ Subsequent to the discussion at the meeting, the Working Group published the consultation on Term SONIA Reference Rates: <https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/consultation-on-term-sonia-reference-rates.pdf>

² Subsequent to the meeting, the Official Sector Steering Group (OSSG) published a paper setting out the authorities' agreed upon views regarding the role of overnight and term risk-free rates in interest rate benchmark reform: <http://www.fsb.org/wp-content/uploads/P120718.pdf>

8. In view of the imminent ISDA consultation on new IBOR fallbacks for OTC derivatives contracts,³ it was agreed to add a foreword to the TSRR consultation to provide context and clarity on the different aims of the two consultations. The ISDA consultation was focused on preventing derivatives market disruption in the event a key IBOR was discontinued, while the Working Group's consultation focussed on how a TSRR could be constructed in order to facilitate sterling LIBOR transition in markets where a term reference might better suit users' needs.
9. The FCA noted that the TSRR consultation did not preclude benchmark administrators taking alternative proposals forward for the construction of a TSRR.
10. Members noted potential risks, including conflicts of interest related risks, associated with the adoption of TSRRs, particularly in OTC derivative markets. It was agreed that the consultation would seek input on risks, including conflicts of interest, and potential mitigants.
11. The Working Group agreed by consensus to delegate final drafting of the consultation and the foreword to the Chair, Vice Chair, Sub-Group Chair and RFR Secretariat. Members would be invited to comment via email on a final version ahead of its publication.

Bond Sub-Group legal discussion paper on LIBOR-linked bonds⁴

12. The Bond Sub-Group Chair introduced the paper.
13. The paper had been drafted in recognition that many market participants continued to issue bonds maturing beyond 2021 which referenced LIBOR. The purpose of the paper was to draw attention to the risks of this activity and identify potential mitigants to those risks. The bond Sub-Group supported publishing this paper so that more market participants could be made aware of these risks. Working Group members noted that issuance of SONIA-linked bonds would avoid these risks.
14. The Working Group agreed to publish the document noting that it would be useful for market participants. It was proposed that the document should include a foreword with some additional context. The Working Group agreed to delegate drafting of this foreword to the Chair, Vice Chairs, Sub-Group Chair and RFR Secretariat.

LMA template on draft replacement rate language for syndicated loans

15. The Loan Sub-Group Chair, who is also the CEO of the LMA, presented the document.
16. Following Andrew Bailey's July 2017 speech on the future of LIBOR,⁵ the LMA had consulted its LIBOR Working Group on amending syndicated loan template documentation to allow transition to an alternative rate. The Loan Sub-Group, also chaired by the LMA, had taken on this work at the beginning of 2018 when it was convened. The language in the template documentation was generic and did not refer to a specific currency or alternative reference rate. It had been shared with relevant RFR Working Groups and trade bodies in other jurisdictions.

³ The ISDA consultation was published subsequent to the meeting: <https://www.isda.org/2018/07/12/interbank-offered-rate-ibor-fallbacks-for-2006-isda-definitions>

⁴ Subsequent to the meeting, the Working Group published the paper on LIBOR-linked bonds: <https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/risk-free-reference-rates-new-issuance-of-sterling-bonds-referencing-LIBOR.pdf?la=en&hash=12F13D37E21F4B789813ED7386F34DA347370323>

⁵ <https://www.fca.org.uk/news/speeches/the-future-of-LIBOR>

17. The template documentation, designed to be used in new syndicated loan contracts, facilitated changing the applicable interest rate benchmark depending on borrower and majority lender consent. Since the language had been drafted without definitive guidance on what the replacement rate or any adjustment spread should be, it referred to an officially sanctioned rate and adjustment spread as a potential alternative. The clause can either apply at any time or upon a “Screen Rate Replacement Event” (with the ‘triggers’ broadly framed). The footnotes of the document also suggested end-users consider the potential read-across to related products such as hedges.
18. A discussion ensued in which the Sub-Group chair confirmed that that users could choose to transition to a rate in line with that defined by ISDA in future
19. The template has been made available on the LMA’s website to its members. The Working Group agreed to also publish a version of the template on the Working Group’s website to ensure that it was available to the broader market. The Working Group delegated drafting of a foreword to the Chair, Vice Chairs, Sub-Group Chair and RFR Secretariat.

State of the market

20. The Chair introduced a discussion about SONIA usage in the market.
21. Members highlighted the recent European Investment Bank SONIA-linked bond issuance as an important transition milestone.⁶ Some members noted the market would need to become more familiar with these types of transactions, particularly the feature in which the interest observation period lags the coupon period by 5 days in order to provide cash flow certainty.
22. ICE Futures provided an update on SONIA futures trading and noted that total ICE SONIA futures outstanding were £15bn. Awareness of transition in the market appeared to be strong but there was still significant scope for volumes to increase. CurveGlobal Futures volumes were also increasing.
23. In the swap market, one member noted that there had been a pick-up in SONIA swap (OIS) volumes but liquidity could be patchy. Some market participants were nervous about warehousing LIBOR-OIS risk at longer tenors given the potential risks around LIBOR discontinuation and the volatile basis at the long end between OIS and LIBOR.
24. It was noted that it was not yet possible to clear SONIA referencing swaps with sub-annual interest payment frequencies. LCH noted that they would be looking at how their SONIA swap product offering could be enhanced before the end of the year.
25. The Bank of England highlighted their recent Financial Stability Report⁷ which drew attention to the stock of GBP LIBOR reference derivatives which had increased since July 2017. The report highlighted that the financial stability risks associated with LIBOR would only reduce if firms transitioned to alternative reference rates.

⁶ http://www.eib.org/investor_relations/press/2018/fi-2018-12-EIB%20issues%20markets%20first%20SONIA%20GBP%20benchmark%20with%20GBP%201bn%205y%20issuance.htm

⁷ <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2018/june-2018.pdf>

Transition metrics

26. The Bank of England introduced an initial list of ideas for transition metrics (no actual data sets were included) which the Bank of England and FCA could start gathering and eventually publish following appropriate governance. The proposed list can be found in Annex 1.
27. The Chair asked for the group's views on whether publishing metrics of this type would be market moving. Some members suggested that these data sets needed to be appropriately aggregated to avoid this risk.
28. The Chair suggested the group publish regular metrics but also draw particular attention to key milestones demonstrated by the metrics.

Sub-Group updates

Syndicated loans

29. The Sub-Group was considering the challenges of adopting SONIA compounded over the interest period in loan markets. The Sub-Group was also considering the extent to which fallbacks would be needed for SONIA or TSRR referencing loan contracts in the future.

Bond markets

30. The sub- group was working on a set of preferred conventions for adoption of SONIA compounded over the interest period in bonds. It was also considering how conversion of legacy LIBOR-linked products to SONIA could be done in practice.

Pension Funds & Insurance companies

31. The Sub-Group had concluded that it did not need to do further work on barriers to adoption for pension funds. It was therefore focussed on adoption for insurance companies where the main barrier was the mandated use of EIOPA LIBOR-based curves for discounting liabilities under Solvency II. The Bank of England had made the Sub-Group aware at its meeting of 19 June 2018 that monitoring LIBOR transition was added as a topic to EIOPA general work on insurance risk free rate.
32. The Sub-Group was considering sending a letter to the authorities on the EIOPA curve issue and other roadblocks to adoption of SONIA for insurance companies including:
 - a. The Solvency II valuation framework's requirement that the SONIA swaps market need to be deep, liquid & transparent (DLT) to be used for discounting purposes;
 - b. The credit risk adjustment (CRA) to liability discounting curves which would need to be amended to reflect that SONIA is risk free;
 - c. For the PRA to consider potential basis risk capital relief for firms adopting SONIA (i.e. via LIBOR OIS basis positions) without the liability discounting curve having changed.
33. The Chair suggested the Sub-Group reach out to the Euro Working Group on Risk-Free Rates to discuss these issues.
34. The Sub-Group Chair also highlighted that there was a concern in the Sub-Group that signing any ISDA protocol to implement an ISDA fallback would have value transfer implications.

Communication & Outreach

35. The Sub-Group had met for the first time one week earlier. Its role will be both to communicate with the market but also to communicate information from the market to the Working Group. It would be developing the Working Group's communication strategy over the coming weeks including undertaking surveys where necessary and considering how best to engage with the media.

Next steps

Potential new Sub-Group

36. The Chair suggested that now would be the right time to consider convening a new market infrastructure Sub-Group to consider what changes to market infrastructure and systems requirements would be required for SONIA instruments to be more widely traded. He welcomed expressions of interest in engaging in this Sub-Group.

ISDA fallback consultation and benchmark transition report

37. In late June ISDA published its Global Benchmark Transition report⁸ including results of a survey of market participants. The survey results suggested awareness of transition was very high and a large percentage of respondents showed willingness to transition over the next 4 years. However, a low percentage of firms had plans or budget in place for transition.

38. ISDA expected their forthcoming consultation on fallbacks to be published on 11th July 2018. It would cover term structures for the fallbacks; proposed credit spread methodologies; triggers; and a governance model. ISDA urged members of the Working Group to respond to this consultation. The Chair suggested that the ISDA consultation should be circulated ahead of the next meeting so that it could be discussed further.

Legal risk associated with Working Group's activities

39. The Chair raised for discussion the question of how the Working Group could best ensure that it operated in accordance with relevant laws, in particular competition law. The approach the Sterling Working Group had taken so far was to require members to take their own legal and competition law advice on how to operate on the Working Group. He noted however that the Alternative Reference Rates Committee ("ARRC") in the US had appointed legal counsel to provide advice to the ARRC, paid for by the committee as a whole. He asked members to liaise with their own legal counsel and consider ahead of the next meeting whether the Working Group should take a similar approach.

AOB

40. The Bank of England had sent a GDPR request to all the firms involved in the Working Group. The Chair reminded members to respond to this request.

⁸ <https://www.isda.org/2018/06/25/ibor-global-benchmark-transition-report/>

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
Shaun Kennedy	Associated British Ports
Sarah Boyce	Association of Corporate Treasurers
Nick Siggers	Bank of America Merrill Lynch
Jon Desler	Barclays
Robert Mitchelson	Blackrock
Timothy Tomalin-Reeves	Citadel
Michael Barron	Deutsche Bank
Axel van Nederveen	European Bank for Reconstruction & Development
Chirag Dave	Goldman Sachs
Daniele Forni	HSBC
Chris Rhodes	ICE Group
Paul Richards	ICMA
Robert Gall	Insight Investment
Ross Barrett	Investment Association
Scott O'Malia	ISDA
Rick Sandilands	ISDA
Clare Dawson	Loan Market Association
Philip Whitehurst	London Stock Exchange Group
Steve Bullock	Lloyds Banking Group
Rob Marshall	M&G Investments
Richard Merrett	Nationwide Building Society
Kwok Liu	National Grid

Official sector attendees

Andrew Hauser	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 Hunnable	Financial Conduct Authority
Adeshini Naidoo	Financial Conduct Authority
Toby Williams	Financial Conduct Authority

Annex – proposed transition metrics [DRAFT]

Data will be aggregated/anonymised and shared with appropriate care taken to ensure that they are not commercially sensitive.

Quantifiable data	
Futures	Open Interest of SONIA Futures, Open Interest of LIBOR Futures
OIS	Volumes by tenor
	Availability by platform (including SEFs)
	Bid/offer spread
	Volumes Outstanding
LIBOR-OIS	Floater-Floater volumes
	Spread curve
LIBOR swaps	Volumes by tenor
	Bid/offer spread
	Volumes outstanding
Bonds	Number of issuances referencing SONIA
Cross Currency	OIS/OIS volumes
Loans	Number of loans referencing SONIA
Market Development data	
Third party vendor readiness	
New OIS structures available for central clearing (e.g. multi-payment)	
New conventions and standards by products (e.g. list of products vs. checklist of standards)	
First trades in products where SONIA not currently established (e.g. FRNs, syndicated loans etc.)	
Relevant IT implementation	
Relevant academic papers	
Regular survey of firms to gauge the use of SONIA for internal processes	
Qualitative data	
Market awareness of, and clear messaging on, the transition to risk-free rates.	
Absence of market disruption.	
Avoidance of litigation.	
Avoidance of disputes between issuers and investors on transition economics.	

Avoidance of material distortion in the SONIA/LIBOR basis swap market.

Absence of transition-related rating downgrades .

Absence of payment disruption during the transition (e.g. delays in interest payments).

Consistency of standard documentation across the market, where consistency is needed.

Feedback from market participants before and after the changeover (e.g. through a questionnaire).

Recommendations by Trade Bodies.

