

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

Wednesday 28 March 2018

FCA offices – 25 North Colonnade

Agenda

1. Introductions, competition law reminder and conflicts of interest
2. Approval of minutes of previous meeting
3. Developments since the previous meeting
4. Working Group milestones document
5. Sub-group and stakeholder forums update
6. International coordination
7. Discussion of potential new sub-groups
8. Possible role of Working Group in ISDA fallback work
9. AOB

Introductions, competition law reminder and conflicts of interest

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. Members were asked to declare any additional conflicts of interest.

Approval of previous meeting's minutes

2. The minutes of the meeting on the 19 February 2018 were approved by the Group.¹

Developments since the previous meeting

3. The Group discussed four key developments since the previous meeting. First, that the Bank had recently published a *Quarterly Bulletin* article which explores the structure of the sterling money markets.² The article presents summary statistics from the Bank's new Sterling Money Market data collection and contains analysis of those markets – including the scarcity of transactions in the unsecured deposit market, which sterling Libor intends to measure – which gives additional context to the Group's mandate.
4. Second, the FCA provided an update on two recent communications: Policy Statement 18/5 – 'Powers in relation to Libor submitters' – which sets the approach, criteria and methodology that is proposed to apply if the FCA's powers to compel banks to contribute to LIBOR were needed. It was noted that the statement affirmed that it was not expected to that these powers be used.³

¹ See www.bankofengland.co.uk/markets/benchmarks

² See www.bankofengland.co.uk/quarterly-bulletin/2018/2018-q1/sterling-money-markets-beneath-the-surface

³ See www.fca.org.uk/publications/policy-statements/ps18-5-powers-relation-libor-contributions

5. The FCA also gave additional detail and context to Andrew Bailey's recent remarks regarding 'synthetic Libor'.⁴ The concept of a synthetic Libor was being explored as a potential last resort for legacy contracts to help smaller or less sophisticated users of Libor for whom transition or the addition of more robust fallbacks may be very difficult; it was expected that the vast majority of market participants would transition their contracts voluntarily and they should not rely on a synthetic Libor (if any) as a way to avoid transition. Some Group members suggested that to minimise basis risks, any synthetic Libor (if any) should align closely with any fallback rates that are developed.
6. Third, the Group noted that ICE Benchmark Administration had published test data on a proposed evolution to the methodology for calculating Libor rates.⁵ The proposed evolution would make greater use of transaction data, but would still rely on the judgement of Libor panel banks for many Libor tenor and currency pairs. It was suggested that the output of the test data was consistent with what might be expected from a shift to using average transacted rates and greater use of transaction data, respectively.
7. Fourth, the recent widening in spreads between Libor rates and equivalent maturity OIS rates: in US dollar markets, 3 month Libor versus 3 month OIS spreads had widened to the highest rate since 2011; in sterling markets, long-dated swap rates had been affected, with 30-year Libor swap versus 30-year OIS spreads reaching record highs.
8. The Group discussed whether the widening in sterling Libor-OIS spreads may be related to flow associated with transitioning from Libor to SONIA swaps. Some members noted that volatility in Libor-OIS spreads may be welcome as it could encourage market activity thereby improving liquidity; others felt that these moves could complicate the use of realised Libor-OIS spreads as an input to any Libor fallback methodology. Some members noted that the volatility might present a good opportunity for market communication from the Group.

Working Group milestones document

9. The Group discussed a draft document detailing milestones for the Group's work. Alongside minor clarifications, two main general comments were made. First that it be clarified that the milestones were aspirational and subject to change. Second, that progress on adopting SONIA should not be restricted for those markets and participants where a term SONIA reference rate is not necessary, and so work on market conventions and best practice for overnight SONIA-referencing products should begin sooner.
10. Subsequent to the meeting a revised draft was circulated to members for further review.

Sub-group and stakeholder forums update

11. The relevant chairs gave updates on the sub-groups and stakeholder forums.

Pension Fund and Insurance Company adoption sub-group

12. The sub-group had been separated into three separate workstreams, looking at pension fund adoption, insurance company adoption issues and metrics of adoption. The sub-group had so far concluded that

⁴ See www.fca.org.uk/news/speeches/recent-developments-financial-markets

⁵ See www.theice.com/iba/libor/testfiledata/031718

there were no material impediments to the adoption of SONIA by the pension fund sector specifically. In contrast, insurance companies were dis-incentivised from adopting SONIA since the discount curve mandated by EIOPA was constructed using Libor swap rates, so use of SONIA-referencing instruments leads to basis risk. In response, the sub-group had considered options for amending the discount curves to reference SONIA, including transitional matters. The Bank acknowledged this issue and noted that it is being considered internally. The sub-group had also considered some metrics for adoption and had designed a survey for members to complete. Such a survey may be rolled out to a broader set of stakeholders, but responses from the sub-group would provide a test of utility.

Term SONIA reference rate sub-group

13. The sub-group chair stated that a draft consultation was intended to be ready for consideration by the Working Group at the next meeting.

Syndicated loan market sub-group

14. The Loan Market Association (LMA) and the Association of Corporate Treasurers (ACT) had jointly produced a guide for loan market participants on SONIA transition, at the request of members of the sub-group. In addition, the LMA, with input from the sub-group, was drafting clauses to address switching to a different benchmark in the event of Libor cessation, which could be used in new contracts or added into existing contracts. The sub-group would also hear from the Chair of the Term Rates sub-group regarding developments in term RFRs and the use of compounded overnight SONIA.

Bond market sub-group

15. The sub-group chair provided an update on two key aspects. First, a paper drafted by a group of legal experts which outlined the legal risks associated with continuing to use Libor as a reference rate in new floating rate note issuance (FRNs) alongside possible mitigants. The paper also sets out likely legal and practical impediments to making any retrospective contractual amendments to FRNs; which in general would prove very difficult. It was also confirmed that in the event that Libor continues to be published then existing contractual fallbacks – usually reverting to the previous rate – would not be triggered.
16. The sub-group had also discussed issues related to the adoption of SONIA and readiness to do so. Sub-group members had contributed their views which, following redaction, would be shared with the Working Group and be used to inform a guide to using SONIA in the bond markets. The sub-group also had a short presentation from the European Investment Bank, discussing the experience with a previously-issued bond which paid coupons based on overnight compounded SONIA rates.
17. Following the updates from the bond and syndicated loan sub-groups, there was a discussion regarding the current availability of non-derivative products which reference overnight compounded SONIA (i.e. backward-looking). Some corporate sector members of the Group stated that they would be keen to use compounded SONIA in loans but are struggling to get interest from their banks and investors. The Group agreed that more could be done to establish market conventions and template documentation for non-derivative products which reference overnight compounded SONIA, so that adoption could begin soon for those users comfortable with this approach. One useful development to

assist in the use of overnight compounded SONIA would be the daily publication, by an independent party, of compounded SONIA over typical payment periods (e.g. one, three and six months).

Industry forums

18. The Banking industry forum had recently met and had discussed the following topics: the need for, and importance of, international coordination between RFR Working Groups; the possibility of providing analytical support to ISDA's work in defining fallback rates for legacy Libor-referencing derivative contracts; the need for broader and consistent education, including within firms; and an initial assessment of possible impediments and corresponding solutions for the adoption of SONIA. A further forum session was scheduled for May.
19. The investment management forum – to be arranged with the Investment Association – was scheduled for 20 April 2018, with a high degree of interest so far. In addition, the corporate forum – to be arranged with the Association of Corporate Treasurers – was being finalised and would be held in May.

International coordination

20. The Group discussed the need for international coordination, with three key aims: i) to improve and ensure consistency of education and communications; to achieve consensus on technical issues which have relevance across currencies; and to ensure consistency of approach and objectives when discussing transition issues with global regulatory bodies.
21. The Chair had spoken to the chairs of the other currency RFR Working Groups who were eager to coordinate on these issues. In addition, the Bank and FCA noted that steps are being taken to correct the perception that there was a lack of international coordination between authorities.

Potential new sub-groups

22. The Group discussed ideas for potential sub-groups. It was agreed that two new sub-groups would be established: one to consider communication, education and outreach issues; and one to design and produce metrics of success for SONIA adoption. There was some support for a sub-group covering accounting and tax issues, but it was agreed that this may need international engagement – which may also be required for cross-currency issues. The Group agreed that sub-groups for technological & operational issues and non-linear products were deemed to be lower priority at this stage.

Possible role of Working Group in ISDA fallback work

23. The Chair asked the Group for views on whether it should become more actively involved in ISDA's work designing fallback rates for legacy contracts. Some members noted that the bond and loan sub-groups' work on fallback rates had similar objectives, so there was clear relevance for the Group. Others also noted that ISDA's deliberations were intimately linked to the adoption of SONIA because some market participants were waiting to see the outcome of fallback considerations before making decisions regarding transition.
24. The Group agreed that they could play a useful role in generating consensus on fallback methodologies and would consider the most appropriate approach. ISDA noted that a consultation on the fallback issues was due to be published in the coming months.

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
Robert Mitchelson	Blackrock
Stergiou Panayiotis	Deutsche Bank
Axel van Nederveen	European Bank for Reconstruction & Development
Tom Gilliam	GlaxoSmithKline
Chirag Dave	Goldman Sachs
Chris Rhodes	ICE Group
Paul Richards	ICMA
Robert Gall	Insight Investment
Ross Barrett	Investment Association
Rick Sandilands	ISDA
Clare Dawson	Loan Market Association
Philip Whitehurst	London Stock Exchange Group
Ian Fox	Lloyds
David Covey	M&G Investments
Terry Barton	Nationwide Building Society
Kwok Liu	National Grid
Kieran Higgins	Royal Bank of Scotland

Official sector attendees

Ed Ocampo	Bank of England
Imane Bakkar	Bank of England
John Budd	Bank of England
Rob Harris	Bank of England
Harriet Hunnoble	Financial Conduct Authority
Devid Mazzonetto	Financial Conduct Authority
Adeshini Naidoo	Financial Conduct Authority
Heather Pilley	Financial Conduct Authority
Toby Williams	Financial Conduct Authority