

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

Thursday 29th November 2018

Bank of England, Threadneedle Street, London

Welcome and 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.

Term SONIA Reference Rates Next Steps

2. Following the publication of the summary of responses to the consultation on Term SONIA Reference Rates (TSRRs)¹ the Working Group discussed the key takeaways and next steps.
3. The summary established that a TSRR would facilitate the transition for some cash market segments, however, while the SONIA derivatives market was seen as capable of providing a basis for a TSRR, there would need to be a step change in market liquidity before such a benchmark would be sufficiently robust. Members discussed how to encourage such a step change with some members emphasising the need for greater trading on transparent electronic platforms. Others mentioned greater end-user demand for underlying spot starting SONIA-linked instruments would improve its robustness.
4. The responses also emphasised the importance of a TSRR being compliant with IOSCO principles. Members highlighted the importance of robustness including the impact on short-term liquidity in the event of a shock or a stress and the risk that relevant banks might withdraw from streaming quotes. It was noted that the performance of a TSRR in these circumstances would be difficult to predict but would be an important consideration for any future administrator.
5. The summary suggested that finding a way to avoid systematic usage of TSRRs in derivatives markets would be important. Members raised concerns regarding what mechanisms would be available to limit the use of a TSRR in derivatives markets and noted that the Working Group did not have the power to do this. In this context, the FCA referred the Working Group to the Official Sector Steering Group's (OSSG) statement in July on the role of overnight and term rates².
6. In light of the responses the Working Group agreed it should consider when a TSRR was likely to be available. Some members emphasised the importance of avoiding giving too much confidence to the market that a TSRR with a particular methodology might develop. It was noted that both the US and Swiss market-led RFR working groups had concluded that it was not yet possible to create a RFR-based term rate for their respective currency markets³.
7. The Chair also fed back from a recent meeting of the Banking Industry stakeholder forum in which concerns were raised about the possibility of using a model-based TSRR due to lack of transparency and potential basis risks between the TSRR and relevant traded instruments. Some forum members had suggested

¹<https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/term-sonia-reference-rates-consultation-summary-of-responses.pdf>

² <http://www.fsb.org/wp-content/uploads/P120718.pdf>

³ <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Progress-Timeline-Oct-30.pdf>;
https://www.snb.ch/n/mmr/reference/minutes_20181031/source/minutes_20181031.n.pdf

greater use of Base rate in some cash instruments, for example SME loans, to provide some degree of cash flow certainty. Forum members also suggested whether it would be possible to limit TSRR usage to the banking book. The forum discussed whether Futures could be used as a fallback for an OIS derived TSRR, and whether quotes utilised could be passive rather than active. The forum opined that more transparency was needed.

8. The Working Group considered what the next steps should be with regard to catalysing development of a robust TSRR including the role of the Working Group. The Chair proposed circulating a draft statement to the members with a view to discussing further at the next Working Group meeting, scheduled for 12 December.

Approach to legal risks associated with the Working Group's work

9. Following the discussion at the November meeting, members who had not yet responded were asked to provide views via email to the secretariat on whether external legal counsel was desirable and, if they deemed it not necessary, explaining the rationale. The Working Group would revisit this issue early in 2019 once its new chair was in place.

Note on new loan transactions referencing Libor

10. The loan sub-group had been drafting a paper on issues for new loan transactions referencing Libor. The paper drew on a similar paper previously drafted by the bond sub-group and published by the Working Group⁴. The secretariat would co-ordinate final comments from the Working Group on the paper ahead of publication.

ISDA fallback consultation

11. The Working Group noted ISDA's preliminary statement on the outcome of its consultation on fallbacks to LIBOR in over the counter (OTC) derivatives contracts⁵.
12. One member noted that if the new fallback clauses were to be implemented through a voluntary change to the relevant protocol, it would be important to try to avoid incomplete uptake, since that could lead to misalignment across products and create the opportunity for arbitrage and fragmentation. It was suggested that to help to avoid this, triggers and fallbacks should be aligned where possible. In particular, the member suggested that ICE Benchmark Administration's contingency methodology for LIBOR should be aligned with the ISDA protocol to avoid providing an incentive for market participants not to adopt the protocol. Members agreed that alignment of triggers and compatibility of fallbacks would be an important area for further discussion.

Sub-group and forum updates

Loan market sub-group

13. The sub-group was continuing to work on proposed documentation for fallbacks to both a TSRR and a compounded SONIA.

⁴ <https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/risk-free-reference-rates-new-issuance-of-sterling-bonds-referencing-libor.pdf>

⁵ <https://www.isda.org/2018/11/27/isda-publishes-preliminary-results-of-benchmark-consultation/>

Bond market sub-group

14. It was noted that there had now been twelve new issues of SONIA linked bonds, totalling over £6bn. The sub-group chair also flagged that the European Investment Bank was in the process of issuing the first bond linked to compounded SOFR.
15. The sub-group's focus had been on deriving a practical market based solution to amending legacy issuance. The sub-group had also agreed key bond market deliverables for 2019. Some of these would be primarily for the sub-group, others required actions from the Working Group and more broadly across the industry. A task force had been convened with members from bond, loan and derivative markets to consider pros and cons for various conventions for referencing SONIA. A discussion paper on this topic was currently being drafted.

Communications & Outreach sub-group

16. The sub-group was planning to publish its first newsletter during November [subsequently published 30 November⁶]. In addition, the sub-group had published a 'starter pack' of information designed to provide background to the transition work for those new to the subject⁷. It was hoped that this pack would provide a helpful and consistent briefing tool.
17. It was emphasised that, in general, the Working Group needed to reach out to those not aware of its work in terms of communications. The sub-group would be considering how best to do this in 2019. There was also a consensus that the sub-group should consider, with other stakeholders internationally, how to make international coordination on the transition more transparent.

Pension Funds & Insurance Company sub-group

18. The sub-group, together with members of the EUR Working Group, had reached out to EIOPA to begin discussions on the interaction between Solvency II and transition. The discussion covered:
- (i) That RFR swaps would need to be grounded in deep, liquid and transparent markets.
 - (ii) Solvency II articles (43), (44) and (45) and their implications for insurers' transition.
 - (iii) The transition from EONIA to ESTER
19. Consideration was also given to whether and how to establish a joint task force to take this work forward.
20. Transition of pension LIBOR positions was underway and no other major issues had been identified at present. The sub-group was planning to carry out regular "pulse checks" to ensure that any issues that arose were captured.

Cross-currency swap sub-group

21. This sub-group, established by the US Alternative Reference Rates committee (ARRC) with membership from RFR working groups in different currency jurisdictions, continued to consider the best way to ensure international alignment in the cross currency swap market. A paper on dealer to dealer swap conventions would likely be circulated to individual RFR Working Groups in due course.

⁶ <https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/newsletter-november-2018.pdf>

⁷ <https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/what-you-need-to-know-about-libor-transition.pdf>

Infrastructure sub-group

22. The sub-group had put together a priorities list of key infrastructure issues. There was demand in the Working Group for this to be discussed at the next meeting subsequent to which it could be republished. The sub-group had also noted there was demand for a published compounded rate and/or a calculator. It was noted that there was a strong link here with the task force on conventions.

Any Other Business

23. The Working Group had held a meeting of accounting firms to discuss accounting issues relating to transition. The Working Group was likely to write a letter to the International Accounting Standards Board offering technical support on RFR transition. It was noted that it would be helpful to engage with other RFR Working Groups internationally on this topic given the mutual relevance.

24. The Working Group noted the publication of the latest OSSG Progress Report on Benchmark Reform, published on 14 November⁸.

25. The Bank of England highlighted its latest Financial Stability Report which provided an update on transition progress⁹.

⁸ <http://www.fsb.org/wp-content/uploads/P141118-1.pdf>

⁹ <https://www.bankofengland.co.uk/financial-stability-report/2018/november-2018>

Private sector attendees

Francois Jourdain
Andreas Giannopoulos
Frances Hinden
Robert de Roeck
Shaun Kennedy
Nick Saggars
Jonathan Brown
Rob Mitchelson
Michael Barron
Axel van Nederveen
Chirag Dave
Daniele Forni
Chris Rhodes
Paul Richards
Robert Gall
Galina Dimitrova
Guy Whitby Smith
Clare Dawson
Philip Whitehurst
Ian Fox
Dave Covey
Richard Merrett
Kieran Higgins
Oliver Cooke

Barclays (Chair)
Barclays (Chair's office)
Shell (Vice Chair)
Aberdeen Standard Investments
Associated British Ports
Bank of America Merrill Lynch
Barclays
BlackRock
Deutsche Bank
European Bank for Reconstruction & Development
Goldman Sachs
HSBC
ICE Group
ICMA
Insight Investment
Investment Association
Legal & General Investment Management
Loan Market Association
London Stock Exchange Group
Lloyds Banking Group
M&G Investments
Nationwide Building Society
Royal Bank of Scotland
Royal Bank of Scotland

Official sector attendees

Imane Bakkar
Josh Jones
Alastair Hughes
Hannah Reynolds
Antoine Lallour
Peter Balint
Radhika Sood
Harriet Hunnoble
Heather Pilley
Devid Mazzonetto
Toby Williams

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