The Working Group on
Sterling Risk-Free Reference Rates

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

Wednesday 16 September 2020

Virtual meeting

Agenda

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    b. Competition law reminder
2. Review of progress and read out of recent meetings
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    b. FSB OSSG meeting
3. Readiness to meet the RFRWG's end-Q3 lending targets
    a. Discussion on lender readiness
    b. Update from LMA on loan template exposure drafts
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4. Discussion of issues relating to proactive amendment of legacy loan contracts
5. Derivatives
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    c. Update on work of Non-Linear Derivatives Task Force
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6. Infrastructure Sub Group analysis and proposed papers for publication
    a. Summary of published beta term rates
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7. Other material updates from Sub-Groups/Task Forces
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Welcome, introductions and competition law principles

1. The Chair welcomed attendees and introduced Credit Suisse as a new member.

2. The Working Group's competition law counsel gave a competition law reminder.

Review of progress and read out of recent meetings

3. The Chair thanked members and their teams for continued support and the work progressed over the summer, which included publication of a number of important documents. In particular, the Group had formally agreed to make two recommendations, both of which had received strong support.

4. The first recommendation concerned the credit adjustment spread methodology for fallbacks in cash market products referencing GBP LIBOR. The Working Group's earlier consultation on this subject had identified a strong consensus in favour of a methodology aligned to that proposed by ISDA for derivative products, and in light of that result, the Group had agreed to formally recommend this approach. A supportive statement was put to accompany this output.[1]

5. The second recommendation concerned conventions for use in loan products based on SONIA compounded in arrears, covering a number of technical areas relating to the calculation and payment of interest. A particular area of interest had been the methodology for implementing a 'lookback' to provide parties sufficient time for notice and collection of payment, where various approaches were available. In this area, the Working Group had recommended use of a five banking days lookback *without* observation shift as the standard approach, while noting that where lenders were also able to offer lookback *with* an observation shift this remained a viable and robust alternative. Overall this recommendation had received strong support from the Group, though one member had noted that the approach put forward would not be consistent with use of the Bank of England's SONIA index and that views on this issue remained mixed, so had preferred not to recommend a single standard approach in this way.

6. The Chair noted the Senior Advisory Group had discussed the Working Group's outputs at its 10 September meeting. There was support for the work to date, including continued efforts to meet the Q3 lending milestones. The Senior Advisory Group also discussed the status of the forthcoming ISDA protocol and the importance of widespread adoption once it was made available.

7. The Bank of England (the Bank) provided an update from the 10 September meeting of the Financial Stability Board's Official Sector Steering Group (OSSG) on benchmark reform. The OSSG was in the process of developing its annual report for publication toward the end of the year. There remained a clear international commitment to delivering a smooth transition in the time available, which had been demonstrated by the efforts to adjust interim milestones where necessary to account for issues related to Covid-19, without losing sight of the underlying weaknesses of LIBOR which had been revealed by the related market volatility.

8. One member asked whether the OSSG had discussed any alignment of targets for ceasing issuance of new LIBOR contracts before end 2021, and whether tough legacy issues had been discussed. The Bank noted that a high-level international roadmap on transition was under consideration to help raise awareness

[1] https://www.bankofengland.co.uk/-/media/boe/files/news/2020/september/the-working-group-on-sterling-risk-free-reference-rates-news-release-securing-a-sonia-based-sterling.pdf

of the steps firms should take to ensure their own readiness, but that it would remain for individual currency areas to set out specific milestones for their markets. The FCA noted that the development of UK legislation to support tough legacy contracts was progressing. Members were reminded of the potential for announcements in relation to LIBOR's future around the end of the year, given IBA's public commitment to provide a year's notice of any planned cessation.

Readiness to meet the RFRWG's end-Q3 lending targets

Discussion on lender readiness

9. Members discussed the Group's upcoming milestones for lenders, by the end of September, to make non-LIBOR alternatives available to customers, and for any continuing LIBOR-linked lending to include clear contractual arrangements to facilitate conversion ahead of end-2021.

10. The RFR Secretariat provided an overview of market readiness, based on an informal survey of a range of lenders. Overall, lenders had reported they were either ready or on a clear path to be by the end of the month. Some noted continuing actions on training, documentation or system work but no outstanding blockers were raised.

11. In terms of take-up of new products on SONIA so far, one major deal had been made public in early September and a number of banks reported a growing pipeline. Where clients were not ready to be able to agree an RFR-deal upfront, the option to agree a switch at a later date was seen as helpful. Where that was used, lenders had noted the importance of setting a date sufficiently far in advance of end-2021.

12. Client readiness to agree SONIA-based loans was seen as somewhat mixed. Significant outreach programmes to borrowers were in train and engagement was being intensified to address this. The Working Group had also announced an increase in its own engagement in September, including a high profile webinar aimed at non-financial corporates, but continued progress would be needed over the next 6 months to meet the next milestone of phasing out LIBOR-linked lending by the end of March.

13. The Working Group discussed these findings and shared further views. Members said they had indeed observed an increase in client demand to discuss non-LIBOR lending in the previous four to six weeks. Client advisors and legal firms had previously been waiting on the availability of documentation so the recent progress made by the LMA was welcomed. It was thought the availability of documentation may also assist in the education and awareness of mid-to-small end of the corporate sector.

14. There also remained some challenges. One corporate member observed that, in its experience so far, some lending banks outside of the Working Group may still have further to go. Another noted that treasury management system upgrades remained a challenge for corporates, which may have a drag on the uptake of SONIA-based loans initially. A third member highlighted that many firms were still responding to the impact of COVID-19 so there was still lots of work to do.

15. One member felt there may be some misinterpretation in the wider market of the recommendation for continuing LIBOR-linked lending to include "clear contractual arrangements to facilitate conversion ahead of end-2021". The Working Group's Q&A guidance had made clear that this was intended to go beyond inclusion of standard fallbacks in contracts to encourage conversion in advance of the end of 2021.

16. In line with the Working Group's use case paper, it was recognised that products like trade finance would need documentation that embed a switch to term SONIA. Working Group members were liaising with trade associations like the Bankers Association for Finance and Trade to provide further guidance and support in this area, and would continue to engage internationally as needed.

17. The Infrastructure Sub-Group was developing a further survey of infrastructure providers and, in light of comments made, would liaise with loan market experts from the Working Group to ensure the survey suitably covered questions on client engagement and potential blockers.

Update from LMA on loan template exposure drafts

18. On 11 September the LMA had published an 'exposure draft' for a multicurrency rate switch lending facility agreement based on the Group's recommended conventions to support the Q3 milestone timeline. Feedback was sought by 29 September.

19. It was noted the LMA was hosting an international virtual meeting to raise education and awareness on transition and the Q3 milestones. It was also working to produce a further switch facility agreement based on the observation shift methodology.

Engagement with corporates

20. The co-chair of the Communications Sub-Group outlined its plans for increased engagement with non-financial corporates, including the intended content for the upcoming webinar, and requested members to send them any events featuring LIBOR transition for inclusion in its forward calendar.

21. One member highlighted that some smaller business groups/trade associations did not have much capacity at this stage but were acting as intermediaries to support education and awareness on transition. The Working Group could consider how to ensure the flow of information to these entities and keep transition on the list of considerations for what firms need to be doing.

Discussion of issues relating to proactive amendment of legacy loan contracts

22. The Chair noted concerns raised by some members over hurdles to proactive transition of legacy loan contracts, including the potential for borrowers to encounter differing approaches between lenders and perceptions of the economic incentives arising from current market pricing. The Working Group was invited to share observations on these issues and consider whether any further steps could be taken to support the market.

23. The chairs of the Cash Legacy Transition Task Force and the Loan Enablers Task Force highlighted the methodology for credit adjustment spreads as a key issue in this respect. Recommendations from ISDA and the Working Group, for derivatives and cash products respectively, had made clear the approach to be taken in relation to the operation of fallback clauses and had helped to anchor expectations. But in respect of amendments being made at an earlier date, the approach needed to be agreed between contracting parties in light of market conditions at the time. A clear market standard for assessing fair value was available in the derivatives market and had been employed successfully in a range of bond conversions, but involved a degree of complexity which may be difficult to explain to a broad range of borrowers in respect of loans.

24. It was also noted that some loans may be transitioned to alternative rates other than SONIA, as set out in the Working Group's Term Rate Use Case paper.[2] Existing guidance on credit adjustment spread methodologies focused specifically on transition to SONIA-based rates, so some members felt that further guidance in this area should be considered. It was recognised that any work in this area would need to be appropriately balanced with the Working Group's primary mandate to facilitate transition to SONIA.

25. It was noted that any further output would need to be considered carefully from a risk perspective and having regard to the remit of the Working Group and its competition obligations. In particular, the Working Group's credit adjustment spread recommendation for application in existing contractual arrangements at the cessation and pre-cessation of LIBOR involved different contextual considerations compared to active conversions, where there could be additional value transfer implications.

26. The Working Group agreed to consider these issues further and asked the Chairs of the Cash Legacy Transition and Loan Enablers Task Forces to look at whether any further output from the Working Group could be of use.

Derivatives

FCA survey on timeline for switching interbank trading conventions

27. Following positive discussions at the previous meeting, the FCA had conducted a survey of liquidity providers to determine support for changing the interest rate swap quoting convention from LIBOR to SONIA in the interdealer market. A strong majority of respondents had supported making this change on 27 October, subject to market conditions at the time, and the Working Group agreed to incorporate this date into its roadmap. FCA asked for volunteers to support market messaging leading up to the event.

Update from ISDA

28. ISDA was awaiting feedback from competition authorities on its protocol and, once obtained, ISDA will make a press statement. Those who wished to adhere in escrow would be able to do so before the formal adherence period began. ISDA was also working on educational materials for different products and would be gathering feedback to continue preparations for the launch of the adherence period.

29. The FCA noted that the ISDA protocol would provide firms with a means to meet supervisory requirements. Widespread adoption would increase the prospects that the FCA would be able to use its proposed new powers to address tough legacy contracts.

Update on work of Non-Linear Derivatives Task Force

30. The co-chairs of the Non-Linear Derivatives Task Force were introduced to the Working Group. They explained the task force was using the result of a UK conventions survey to map the structure for new flows in non-linear RFR derivatives, which included (amongst others) swaptions, caps, floors, constant maturity swaps, and range accruals. As part of that process they were looking to minimise any compatibility issues between hedging derivatives and the underlying products, and were also seeking to identify and help to address any infrastructure challenges.

[2] https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/use-cases-of-benchmark-rates-compounded-in-arrears-term-rate-and-further-alternatives.pdf

31. One of the issues to consider included the treatment of legacy LIBOR swaps arising from settlement of LIBOR swaptions, in particular how these might be treated by central clearing parties. Another was the implications of any cessation of the LIBOR ICE swap rate, which was referenced by swaptions and constant maturity swaps, where the task force was investigating whether it was possible for an RFR-based version of this to continue for product continuity. The task force was also discussing the treatment of legacy caps and floors in transition.

32. A representative from ISDA on the task force commented that the work was useful, particularly around identifying what could be done for the LIBOR ICE swap rate. ISDA would be producing fallback guidance on all derivatives to detail how they interact with IBORs and this would be made publically available soon.

Update on term rate and OIS streaming

33. There were currently 3 term SONIA reference rates in beta production, allowing for a period of testing and observation of their behaviour before they would be made available for use in live contracts. A fourth provider was no longer intending to produce a rate as previously envisaged. A further discussion around the experience from the testing phase so far would be scheduled for the next meeting.

Infrastructure Sub Group analysis and proposed papers for publication

34. The co-chairs of the Infrastructure Sub-Group introduced two papers intended for future publication. The first was a summary of published beta term rates, intended to assist market participants and vendors relying on these benchmarks. The second was a summary of freely available SONIA calculators, which identified and collated what was available in the market today. Working Group members were directed to provide feedback via the RFR Secretariat ahead of publication.

Other material updates from Sub-Groups/Task Forces

35. The Bonds Sub-Group were due to discuss the lag and shift methodologies to consider the path forward for the bond market, noting the recent issue of a £1bn note referencing the SONIA Index published by the Bank using the shift methodology. It would also investigate whether the process for the active conversion of bonds could be made more efficient.

36. The Accounting Treatments Task Force was preparing a response on behalf of the Working Group to the FRC's Request for Comment on their endorsement of the amendments to various IFRSs to account for Interest Rate Benchmark Reform. The deadline for responses was 28 September 2020. Working Group members approved of the approach and were directed to contact the RFR Secretariat if they wanted sight of the response.

37. The Pensions Funds, and Insurance Companies and Asset Managers Sub-Group held its first meeting on 7 September 2020, having expanded its remit to include asset managers and investment managers.

AOB

38. One member suggested that structured note products could be considered further by the Non-Linear Derivatives Task Force and/or Bond Sub-Group. The Chair agreed to this and suggested the RFR Secretariat help co-ordinate the work.

Private sector attendees

Tushar Morzaria	**Barclays (Chair)**
Paul Mansour	**Barclays (Chair’s office)**
Andreas Giannopoulos	**Barclays (Chair’s office)**
Alan Coutts	**Aberdeen Standard Investments**
Shaun Kennedy	**ABP Ports**
Alexandre Papadacci	**Axa Investment Managers**
James Winterton	**Association of Corporate Treasurers**
Snigdha Singh	**Bank of America Merrill Lynch**
Doug Laurie	**Barclays**
Jonathan Brown	**Barclays**
Rob Mitchelson	**Blackrock**
Ryan O’Keeffe	**Blackrock**
Greg Olsen	**Clifford Chance (Competition law Counsel)**
Martial Collet-Billon	**Deutsche Bank**
Axel van Nederveen	**EBRD**
Chirag Dave	**Goldman Sachs**
Sander Slotema	**HSBC**
John Sullivan	**HSBC**
Paul Richards	**ICMA**
Robert Gall	**Insight Investment**
Rick Sandilands	**ISDA**
Philip Whitehurst	**LCH**
Guy Whitby Smith	**Legal & General Investment Management**
Ian Fox	**Lloyds Banking Group**
Clare Dawson	**Loan Market Association**
Kasia Abendan	**M&G**
Richard Merrett	**Nationwide Building Society**
Kwok Liu	**National Grid**
Phil Lloyd	**NatWest Markets**
Oliver Cooke	**NatWest Markets**
Bob Goodfellow	**NatWest Markets**
Jamieson Thrower	**NatWest Markets**
Frances Hinden	**Shell International Limited**
Zsolt Szollosi	**UBS**
Daniel Cichocki	**UK Finance**

Official sector attendees

Alastair Hughes	**Bank of England**
Wayne Leslie	**Bank of England**
Joanna Froy	**Bank of England**
Alieda Moore	**Bank of England**
Jugvinder Singh	**Bank of England**
Leman Menguturk	**Bank of England**
Edwin Schooling Latter	**Financial Conduct Authority**
Helen Boyd	**Financial Conduct Authority**
Toby Williams	**Financial Conduct Authority**
Heather Pilley	**Financial Conduct Authority**
Will Davies	**Financial Conduct Authority**