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

23 February 2021

Virtual meeting

Agenda

1. Standing items
   a. Welcome & introductions
   b. Competition law reminder
   c. Minutes from January RFRWG meeting

2. Review of progress
   a. RFRWG publications
   b. FCA consultations

3. Readout from February Senior Advisory Group and FSB OSSG meetings

4. Loan Market Transition
   a. Sign-off on LETF's 'Best Practice Guide for GBP loans' paper & 'GBP loan market Q&A for the Working Group's end-Q1 2021 recommended milestone'

5. Derivative Market Transition
   a. Sign-off on 'Path to ending new use in GBP LIBOR derivatives' paper & RFRWG roadmap updates
   b. Discussion on draft paper on 'Operationalisation of fallbacks for non-cleared linear derivatives'
   c. Update on LCH consultation

6. Bond Market Transition
   a. Update on active transition of legacy bonds
   b. Update on tough legacy

7. Update from Communications & Outreach Sub-Group

8. AOB

Standing items

1. The Chair welcomed attendees and thanked Working Group members for their continued engagement.
2. The Working Group's competition law counsel gave a competition law reminder. The Chair requested any comments on the minutes of the January 2021 meeting be sent to the RFR Secretariat.

Review of Progress

RFRWG publications

3. The Chair outlined two publications from the Working Group in February. Firstly, a consultation paper on the successor rate to GBP LIBOR in legacy bonds which would remain open until 16 March 2021. The Chair and Tom Horn (Bank of England) encouraged members to share the consultation paper with their networks as the Working Group sought feedback from as broad a range of market participants as possible. Secondly, the Working Group had published its paper setting out a potential methodology using SONIA-based rates which could form a replacement for GBP LIBOR ICE Swap Rate (ISR), which was viewed as an important building block for transition of the non-linear derivatives market.

FCA consultations

4. Toby Williams (FCA) thanked those Working Group members that attended workshops ahead of the FCA's upcoming consultation in Q2 2021, on its proposed policy for the use of powers under Articles 21A and 23C proposed in the Financial Services Bill as amendments to the Benchmarks Regulation (BMR).
5. HM Treasury (HMT) had recently published a consultation to seek views on whether a legal 'safe harbour' for legacy contracts referencing a benchmark designated under Article 23A of the BMR could be a useful supplement to amendments proposed to the BMR by the Financial Services Bill. A number of stakeholders had suggested exploring additional legal protections alongside existing provisions in the Financial Services Bill. The consultation would close on 15 March 2021 and market participants were encouraged to provide their feedback directly to HMT.
6. Toby Williams also reminded members that consultations had recently closed from the FCA relating to Articles 23A and 23D of the BMR, and from IBA on proposed cessation dates for LIBOR. Members were referred to a public speech by Edwin Schooling-Latter (FCA) at end-January 2021 and the FCA website for further information on how the FCA would announce LIBOR contractual triggers and its view that these announcements should not be delayed longer than necessary so could be expected relatively soon.

Readout from the February Senior Advisory Group and FSB OSSG meetings

7. The Chair introduced an update from the recent meeting of the Senior Advisory Group (SAG). The meeting was attended by Sir Dave Ramsden (Deputy Governor, Markets & Banking), Sarah Breeden (Executive Director, UK Deposit Takers) and David Bailey (Executive Director, International Banks) from the Bank of England as guest speakers. The agenda focussed on the Working Group's recommended milestones and the Prudential Regulation Authority's (PRA) supervisory approach and expectations in relation to those. The Chair noted that the direction of travel was clear and that there was strong support among SAG members to adhere to milestones.
8. Alastair Hughes (Bank of England) noted the positive impact of the October 'SONIA first' convention switch in sterling interdealer swap markets, with a majority share of trading taking place on SONIA and recent progress in longer tenors and that the overall supervisory message remained consistent with publications and announcements made since Andrew Bailey's speech in 2017[1]. The Working Group milestones, which the PRA support, should enable a measured transition and management of associated risks. At the SAG meeting:
    a. The PRA representatives indicated that supervisory oversight would intensify over the coming weeks and months, with an active meeting programme and monitoring in place to see firms make progress in line with industry milestones.
    b. The lending market was noted as a more challenging area than other segments. The PRA was monitoring firms' preparation and saw that compounded in arrears SONIA was actively being used across bi-lateral, syndicated and multicurrency deals. However, data from Q4 2020 suggested less than 20% of new commercial lending was taking place on a 'day 1' SONIA basis. This was not a volume that gave the PRA comfort that all firms had made the necessary preparations to meet the Q1 2021 GBP lending milestone.
    c. The PRA had been made aware of some firms in syndicates holding back progress by advising clients to remain on LIBOR. There was a strong message from the PRA that they would not allow these firms to act as a brake on transition. Long lead times for the necessary changes had already been accounted for through staggered milestones, with an end-Q3 2020 target of firms to actively offer alternatives ahead of ceasing GBP LIBOR issuance at end-Q1 2021.
    d. Turning to legacy contracts, the PRA's expectation was that wherever possible all legacy LIBOR contracts would be amended to include at least a contractually robust fallback, or preferably an agreed conversion to an alternative rate no later than the end of 2021. Banks should have regard for evolving market consensus on relatively limited use of term SONIA, noting the Working Group's own paper on use cases[2]. The PRA

[1] https://www.fca.org.uk/news/speeches/the-future-of-libor
[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

understood firms would have limited unilateral powers to change contracts, and expected them to take a risk-based approach by, for example, focussing on exposures without fallback arrangements.

e. Within syndicated lending markets, the PRA expected the lead arranger to proactively consult with other banks on a timeline consistent with Working Group milestones. Lead arrangers and syndicate members should make their supervisors aware if they were not receiving satisfactory engagement.

9. The FCA noted to the Working Group its alignment with the PRA's approach presented at the SAG meeting. Letters to SMFs, conduct Q&As and speeches had set out the FCA's expectations of firms on LIBOR transition. Firms would need to ensure they considered the increasing conduct risks associated with continued offering of LIBOR products especially where liquidity in these products was likely to deteriorate. The FCA noted that moving away from LIBOR was the most effective way to mitigate conduct concerns and would challenge firms where it believed they should be doing more to shift business away from LIBOR. The FCA and the PRA would act on intelligence where syndicates were not shifting away from GBP LIBOR and the FCA had already had conversations on this with some participants of a syndicate deal that closes in Q2 2021.

10. UK Finance welcomed the clarity of expectations for all lenders, including those outside the Working Group, as this would support engagement with lenders and end-users, as well as reducing any potential inertia. UK Finance noted that in some circumstances where there was an urgent need for liquidity and a customer was unable to handle SONIA, there may be a need for firms to seek some exceptions, but the overall message was that this should be discouraged in the majority of circumstances.

11. The ACT noted support for the messaging from supervisors, which would bring market participants up to speed and in particular help with consistency within syndicates.

12. One Working Group member queried how best to deal with some challenges in multicurrency lending, particularly where sterling may not be the lead currency. The Chair noted it was for the lead arranger to manage this transition in order to avoid risks for their own firm and clients associated with the continued use of LIBOR.

13. The Chair also noted that at the February meeting of the Financial Stability Board's Official Sector Steering Group (OSSG), chairs of national working groups had been invited to provide updates on progress in their jurisdictions. For the UK, the Working Group Chair had encouraged other authorities to stand alongside UK authorities to ensure sterling LIBOR transactions were not being booked outside the UK past the end-Q1 2021 milestone. The Bank highlighted that examples of multicurrency deals were already in place with a robust non-LIBOR sterling leg, demonstrating its feasibility. It was recognised that the lead bank may be booking the deal outside of the UK, but to the extent they were part of a regulated group in the UK, supervisors would take a dim view on them not following Working Group guidelines. While some differences in currency timelines were recognised, messaging from US regulators and the ARRC had also highlighted that USD LIBOR should stop being used as soon as practicable.

Loan Market Transition

Sign-off on LETF's 'Best Practice Guide for GBP loans' paper & 'GBP loan market Q&A for the Working Group's end-Q1 2021 recommended milestone'

14. Jamieson Thrower (Chair, Loan Enablers Task Force) presented two documents for sign-off by the Working Group. Firstly, a Best Practice Guide for GBP loans intended to assist market participants in adopting SONIA in the GBP loan market in order to meet the Working Group milestones by acting as a single source of previously recommended conventions. The paper briefly touched on non-GBP elements, or where GBP was an optional currency in a multicurrency facility, as the LETF recognised this was often cited as an area for further clarity. Secondly, a Q&A document aimed to answer the most commonly asked questions regarding the end-Q1 2021 milestone.
15. Arif Merali (Bank of England) noted the end-Q1 2021 milestones were a significant focus for the Working Group and strong supervisory focus from the official sector. Market intelligence showed good progress in the bilateral space, with challenges in syndicated lending. These documents were intended to help overcome these challenges.
16. One member welcomed these papers and noted the Working Group's paper on Credit Adjustment Spread methods for active transition of GBP LIBOR referencing loans, published in December, may have been missed by the wider market[3]. Another member also supported the paper and welcomed thoughts from the Communications Sub-Group on how best to relay the messaging, perhaps by leading with the Q&A document. Feedback from trade associations suggested a need to make documents and messaging easily digestible for clients who were facing challenges elsewhere.
17. Daniel Cichocki (UK Finance) provided an update on a survey conducted by UK Finance on its members' readiness for, and adoption of, SONIA in the lending market, which echoed feedback from the official sector. UK Finance was supportive of the two papers which would provide clarity ahead of the end-Q1 2021 milestone and would support their widespread dissemination.
18. Clare Dawson (LMA) provided an update on the LMA's progress on producing RFR based documentation.

Derivatives Market Transition

Sign-off on 'Path to ending new use in GBP LIBOR derivatives' paper & RFRWG roadmap updates

19. Arif Merali (Bank of England) introduced the 'Path to ending new use of GBP LIBOR derivatives' paper, which sought to provide further detail on the exceptions for risk management of existing positions, included in the Working Group's roadmap and milestones related to derivatives. These had been developed by an informal group of Working Group members as agreed at the January meeting.

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[3] https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/credit-adjustment-spread-methods-for-active-transition-of-gbp-libor-referencing-loans.pdf

20. The exceptions described in the paper were intended to primarily address unintended consequences of a hard cut-off, including permitting streaming of LIBOR swaps to facilitate the production of the LIBOR ICE Swap Rate (ISR) which underpins the non-linear market, and to support active transition flows from clients. However the key expectation of the Working Group in light of the Working Group's milestones remained for any new GBP derivatives entered into after the milestones to be based on SONIA.
21. The RFR secretariat had also engaged separately with exchanges and other participants in futures markets, such as liquidity providers, to seek their views on transition of exchange traded derivatives. Liquidity in SONIA in futures markets had shown encouraging growth, to around 25% of the overall market in recent weeks, but remained lower than in swaps. Exchange traded products also spanned both linear and non-linear markets, with strong links between the two, so there had been support for a generalised exception for trading in these products until end-Q2 2021, in line with the broader milestone for non-linear derivatives. There was also strong support for further measures to promote transition within this timeframe, so the FCA, supported by the Bank, would work with the market to find a suitable date to encourage a convention switch for futures towards the end of Q2 2021.
22. One member expressed a view that the document found the right balance between stressing urgency of timelines while ensuring sufficient exceptions were in place to prevent transition efforts from being impeded in any way and allow market making and support for end-user liquidity.
23. Another member highlighted that the market was seeking guidance on the end-Q1 2021 milestone and would benefit from timely publication of this document. The non-linear, cross-currency and futures markets were not ready for a pure SONIA-first initiative but it would be important to maintain momentum and build on existing progress made in the SONIA market. The document found a balance which allowed for exceptions to facilitate transition, for example, by allowing the recycling of risk via basis swap market and interbank market while limiting the outright traded amount on LIBOR.
24. Toby Williams (FCA) noted support for the document which provided a simple path towards transition and progress toward achieving Working Group objectives.
25. One member welcomed the further clarity around these exceptions to the overarching position on ceasing new issuance of GBP LIBOR derivatives, noting also that it was important for the market to remain clear on the FCA's stated position that any synthetic LIBOR rate that may be continued to be produced beyond the end of 2021 would be subject to an automatic prohibition on all new trading. Limiting trading to the proposed set of exceptions after Q1 2021 would be an important step towards that.
26. It was agreed the document would be published as soon as possible.

Discussion on draft paper on 'Operationalisation of fallbacks for non-cleared linear derivatives'

27. Rob Buchanan (JP Morgan) was welcomed to the meeting to update on the Infrastructure Sub-

Group's work on a paper aimed to provide market participants considerations to their planning and preparation for the operationalisation of fallbacks of non-cleared linear GBP LIBOR derivatives. The paper would not be an exhaustive checklist, but instead provide a set of themes, considerations and potential next steps to facilitate discussions and prepare for internal planning. The paper was currently in draft form but had received positive feedback from Bloomberg, ISDA and UK Finance through the sub-group. While the Working Group roadmap envisaged this paper being published in Q1 2021, it was agreed that there would be limited value in publishing the paper ahead of any IBA or FCA announcements which may result in 'spread adjustments' being fixed and could, as a result, simplify messaging within the paper. The paper would emphasise that proactive transition is the preferred method, and highlight the Working Group's milestone for active conversion to take place through to end-Q3 2021.

28. One member asked about the Working Group's position on the relative merits of active transition compared to reliance on fallbacks, noting that there was a mix of views in the market so some further communication may be of use in this area. The Chair noted actively transitioning business wherever possible – in line with the Working Group's milestones – would put less pressure on fallback mechanisms, with less to be done later in the year and therefore a potentially smoother path operationally. Rick Sandilands (ISDA) noted that while ISDA fallbacks would move contracts to use of RFRs economically, they would retain a LIBOR label and some non-standard features relative to most Overnight Index Swaps, including a 2-day backward shift. This would likely require distinct administrative treatment relative to standard RFR products on an ongoing basis. Another member noted more nuanced messaging may be required for end-users who would need to make trade-offs when aiming for consistency with other products.
29. Tom Horn (Bank of England) noted the Working Group's messaging to date could be summarised in two tiers – that robust fallbacks should be put in place to the greatest extent possible to provide a backstop, and that ideally contracts would be actively transitioned where possible. Once fallbacks were in place and the relevant 'spread adjustments' fixed, the economic certainty should leave market participants in a good position to agree an active transition in many cases. The Secretariat would aim to identify opportunities for the Working Group to reinforce and clarify this message, including within the operationalisation of fallbacks paper.
30. In relation to the remainder of the paper, one member highlighted that the market was taking differing technical approaches to fallbacks, for example with some looking to re-book trades, while others wanted to reflect fallbacks synthetically via market data reference changes. It may be helpful to seek a common market standard regarding any technology implementation that was required, which could be included in this document.

Update on LCH consultation

31. Phil Whitehurst (LCH) provided an update on the recent consultation run by LCH, which sought views on its proposal to perform a compensated conversion of LIBOR trades into market

standard SONIA equivalents at, or shortly before, the Index Cessation Effective Date. Pending confirmation from the IBA's consultation, the last publication date of certain LIBOR tenors and currencies was expected to be 31 December 2021 and LCH would look to run a conversion process very shortly before that. The compensated conversion would aim to be present-value neutral from the perspective of market participants to avoid value transfers. It was also intended to eliminate the backward shift introduced as a function of ISDA's fallbacks for greater consistency with standard OIS transactions.

32. LCH had originally proposed to flatten the spread on RFR contracts produced and to settle economic difference as an up-front payment. Consultation feedback had demonstrated an alternative consensus on carrying the spread adjustment on the RFR leg of the transaction and LCH had modified its proposal accordingly.
33. One member noted broad support for LCH's effort and highlighted the importance of establishing consensus across the market around the chosen conversion date to achieve the smoothest conversion process.

Bond Market Transition

Update on active transition of legacy bonds

34. Paul Richards (Chair, Bond Market Sub-Group) noted that new floating rate notes and securitisations had been referencing compounded SONIA for some time. The Bond Market Sub-Group was undertaking some work on identification of legacy LIBOR contracts that could be converted, ahead of the end-Q1 2021 milestone, to assist in their orderly wind-down. The market had successfully transitioned approximately 25% of legacy GBP LIBOR bonds through around 40 consent solicitation processes so far. However, transition of some legacy bonds was difficult and slow. Accordingly, the Bond Market Sub-Group had held a consent solicitation workshop which may result in minor improvements to the process.

Update on tough legacy

35. Paul Richards noted three areas of challenge related to legacy instruments. Firstly, for those legacy GBP LIBOR bonds that would not be able to transition, a large majority would fall back from a floating rate to a fixed rate at LIBOR cessation, an undesirable outcome, and therefore the proposed powers for the FCA under the Financial Services Bill in respect of synthetic LIBOR were welcomed as synthetic LIBOR may provide a solution for tough legacy bonds. Secondly, HMT's consultation on the case for a safe harbour against litigation under English Law was welcomed as a step to explore and potentially minimise legal risks associated with transition. Finally, there was a need for greater clarity over time on the interaction between steps taken in relation to tough legacy contracts in different jurisdictions to ensure consistent outcomes, particularly for cross-border contracts.

Update from Communications & Outreach Sub-Group

36. Phil Lloyd (Co-Chair, Communications & Outreach Sub-Group) noted continued engagement with other Sub-Groups and Task Forces to deliver Working Group messaging to a wider audience.

AOB

37. Tom Horn (Bank of England) provided an update on the FICC Markets Standards Board's (FMSB) ongoing work on a market standard for use of Term SONIA rates. The draft paper had reached a relatively stable form, with efforts now focused on precise drafting in a small number of areas, and remained broadly consistent with the Working Group's own Use Case paper. The proposal remained subject to FMSB Board approval, but if agreed would be published as a transparency draft shortly thereafter for public comment. The RFR Secretariat would coordinate a draft statement from the Working Group to help highlight the FMSB's work on this issue and to raise awareness, which would be circulated to members by written procedure for approval prior to publication of the FMSB's transparency draft.

Private sector attendees

Tushar Morzaria	Barclays (Chair)
Paul Mansour	Barclays (Chair's Office)
Andreas Giannopoulos	Barclays (Chair's Office)
Helen Robinson	Barclays (Chair's Office)
Alan Coutts	Aberdeen Standard Investments
Sarah Boyce	Association of Corporate Treasurers
Katherine Ashdown	Bank of America
Doug Laurie	Barclays
Jonathan Brown	Barclays
Robert Mitchelson	Blackrock
Ryan O'Keefe	Blackrock
Greg Olsen	Clifford Chance (Competition Law Counsel)
Zsolt Szollosi	Credit Suisse
Michael Barron	Deutsche Bank
Simon Goodwin	Deutsche Bank
Axel van Nederveen	EBRD
Chirag Dave	Goldman Sachs
Philippe Henry	HSBC
Matthew Horton	ICE Futures Europe
Paul Richards	ICMA
Robert Gall	Insight Investment

Galina Dimitrova	The Investment Association
Rick Sandilands	ISDA
Kari Hallgrimsson	JP Morgan
Robert Buchanan	JP Morgan
Philip Whitehurst	LCH
Guy Whitby-Smith	Legal & General Investment Management
Ian Fox	Lloyds Banking Group
Clare Dawson	Loan Market Association
Tom Dyson	Nationwide
Phil Lloyd	NatWest Markets
Jamieson Thrower	NatWest Markets
Katarzyna Abendan	Prudential
Frances Hinden	Shell
Hannah Faith	UBS
Daniel Cichocki	UK Finance
Stephen Pegge	UK Finance

Official sector attendees

Alastair Hughes	Bank of England
Peter Balint	Bank of England
Arif Merali	Bank of England
Tom Horn	Bank of England
Joanna Froy	Bank of England
Jugvinder Singh	Bank of England
Stefania Spiga	Bank of England
Leman Menguturk	Bank of England
Raza Rehman	Bank of England
Heather Pilley	Financial Conduct Authority
Toby Williams	Financial Conduct Authority
Anne-Laure Condat	Financial Conduct Authority
April Richardson	Financial Conduct Authority