



BANK OF ENGLAND

# **ACT Annual Conference 2018**

## Benchmark Reform

16 May 2018

# Transition to Risk-Free Rates

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# Introduction

## FSB 2014 Report on Reforming Interest Rate Benchmarks

Two key recommendations:

- **Strengthen existing IBORs**
  - Anchor in transactions
  - Fully implement IOSCO principles
- **Develop alternative nearly risk-free reference rates**
  - Better suited for use in many applications



Benchmark Reform

# Strengthening LIBOR

## Key challenges

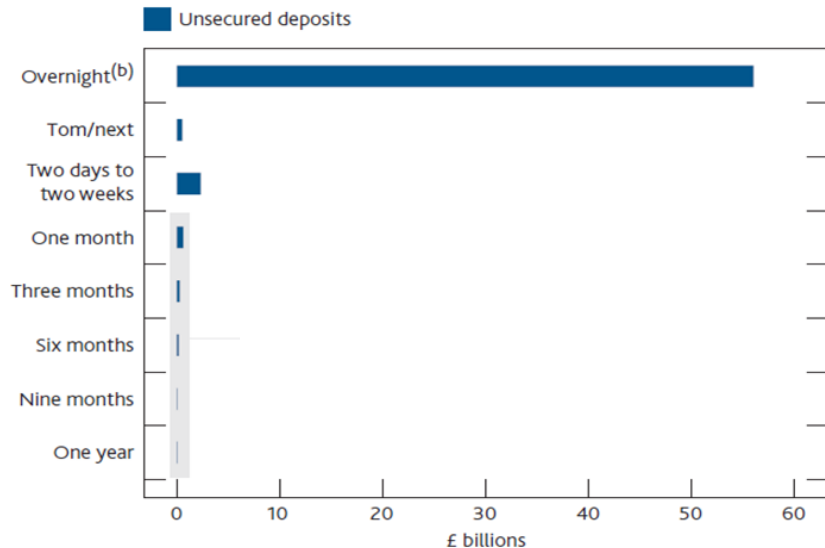
- Lack of term deposit transactions



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# Strengthening LIBOR



Sources: SMM data collection and Bank calculations.

(a) Daily average from 1 September to 30 November 2017, by original maturity.

(b) With a minimum transaction size of £1 million. Transactions underpinning reformed SONIA are £25 million or greater.

- There is little activity in sterling unsecured deposits at maturities beyond overnight



# Strengthening LIBOR

## Key challenges

- Lack of term deposit transactions
- Panel banks uncomfortable submitting based on judgement; risk they could withdraw
- Unplanned disappearance of LIBOR would lead to significant market disruption

## The way forward – Andrew Bailey speech 27 July 2017

- Panel bank support to sustain LIBOR until end-2021 to enable transition
- **“Our intention is that, at the end of this period, it would no longer be necessary for the FCA to persuade, or compel, banks to submit to LIBOR.”**



## Developing alternative RFRs - UK

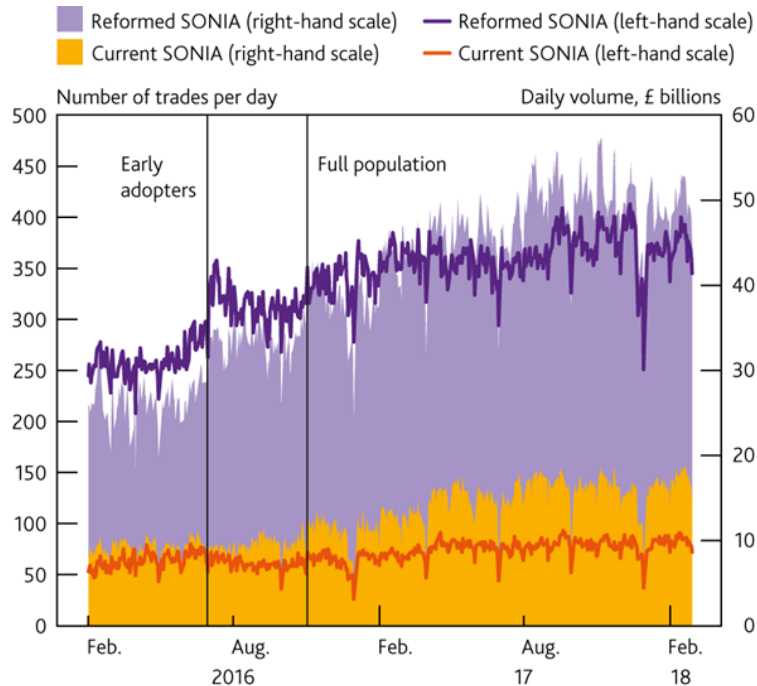
Market-led working Group on Sterling Risk-Free Reference Rates convened in 2015:

- **First phase (2015-2017)** – identify a preferred sterling RFR
- **Second phase (2018 - )** – catalyse transition to the RFR



## Benchmark Reform

# Developing alternative RFRs - UK



- The Bank has reformed SONIA to make it more robust
- Selected at the preferred sterling RFR in April 2017



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## Developing alternative RFRs - Internationally

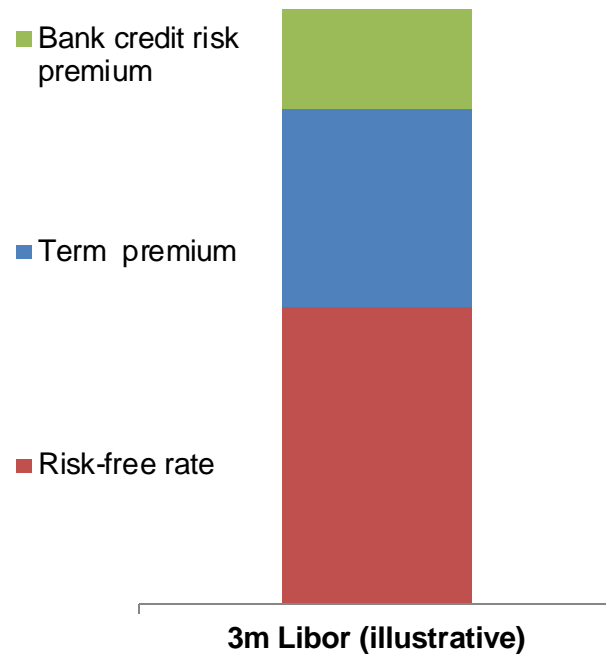
- Official Sector Steering Group (OSSG), convened by FSB, co-ordinates efforts of international authorities
- Working groups have been established for each of the LIBOR currencies

Currency	RFR
USD	Secured Overnight Financing Rate (live from April 2018)
CHF	Swiss Overnight Rate (replaced TOIS benchmark upon termination in December 2017)
JPY	Tokyo Overnight Average Rate (already used in OIS market)
EUR	TBC – WG convened to consider alternative rate



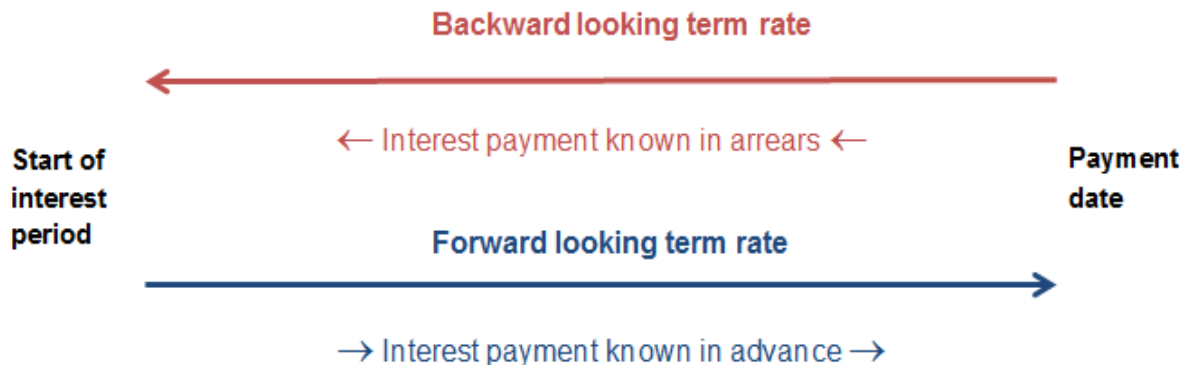
# Transition

- What's the difference between LIBOR and RFR?
- Do interest rate benchmarks need a credit risk premium?

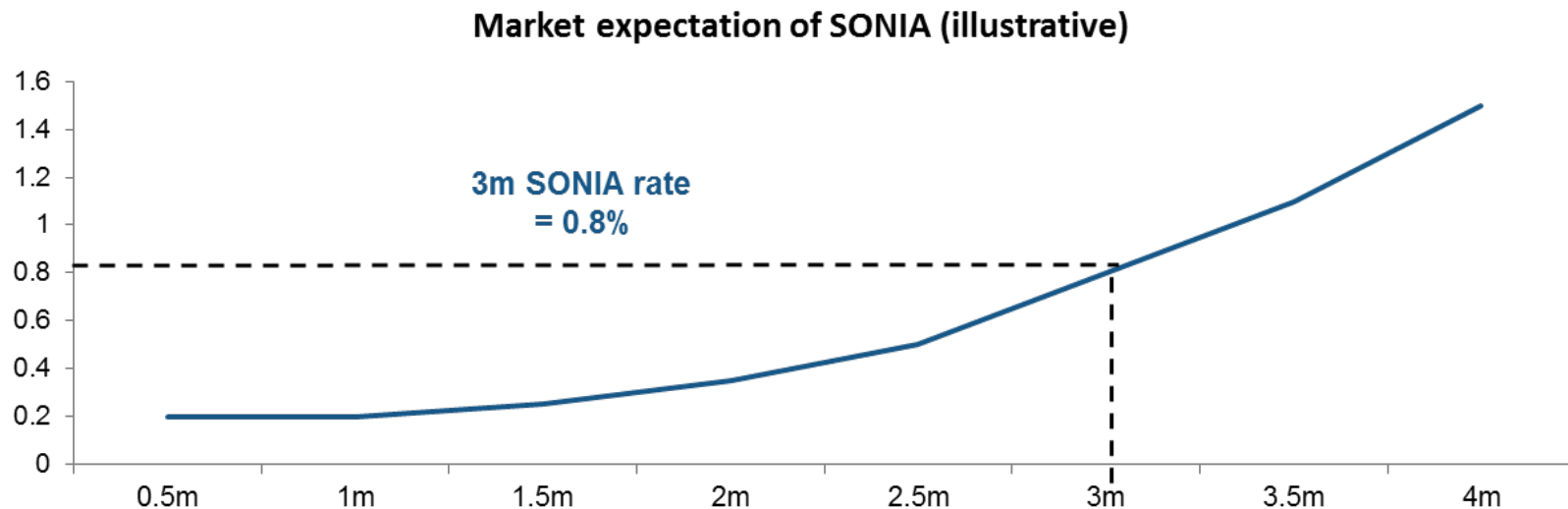


# Transition – Do interest rate benchmarks need a term premium?

- Two ways to calculate term rates



# Transition – Do interest rate benchmarks need a term premium?



## Transition – Next steps

- Working Group key milestones for 2018
  - Term reference rate consultation – Q2
  - Communicating best practice for referencing SONIA in contracts – for example, market conventions for how a backward looking rate can be used in cash markets.
- Corporate stakeholder forum to facilitate broader engagement with corporate community. First meeting organised for 22<sup>nd</sup> May.
- We welcome involvement from corporates in this work. Please express interest to [RFR.Secretariat@bankofengland.co.uk](mailto:RFR.Secretariat@bankofengland.co.uk)

