

Working group on CHF reference interest rates

Minutes from the 17th meeting (5 October 2017)

Attendees:

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| Martin Bardenhewer | – Zürcher Kantonalbank, co-chair |
| Marcel Zimmermann | – SNB, official sector representative, co-chair |
| Christian Bahr | – SIX Swiss Exchange., SRR administrator |
| Matthias Blank | – Zürcher Kantonalbank (by phone) |
| Marc Bonfils | – PostFinance |
| Beat Cavegn | – Cosmorex |
| Patrik Epstein | – Cosmorex |
| Fernando Fasciati | – Raiffeisen |
| Andreas Franke | – Eurex Clearing (by phone) |
| Jonathan Franklin | – ICAP |
| Beat Gabathuler | – Zürcher Kantonalbank |
| Flavio Gadola | – Credit Suisse (by phone) |
| Raffael Goldenberger | – Entris Banking |
| Thomas Graf | – Valiant Bank (by phone) |
| David Horner | – LCH |
| Otto Huber | – Credit Suisse, Chair CHF Alternative Rates Working Group |
| Colt Lake | – UBS |
| Ernst Lienhard | – Swiss Re |
| Dominic Makin | – Gottex Brokers (by phone) |
| Cédric Martin | – Leonteq Securities |
| Michael Newman | – Barclays PLC (by phone) |
| Tim Nicholson | – Gottex Brokers (by phone) |
| Stefan Pomberger | – Bank Vontobel |
| Ludovic Peter | – BNP Paribas (by phone) |
| Raeto von Sprecher | – SIX Repo |
| Marco Steiner | – Pictet & Cie |
| Roland Studer | – Credit Suisse |
| Thomas Sturzenegger | – Bank Julius Bär & Co |
| Matthias Vögeli | – Swiss Life |
| Andreas Wälchli | – Basler Kantonalbank |
| Kathrin Wehrli | – Credit Suisse (by phone) |
| Philip Whitehurst | – LCH |
| Michael Brandstätter | – FINMA, official sector representative |
| Roman Baumann | – SNB, official sector representative |
| Matthias Jüttner | – SNB, official sector representative |
| Surya Singh | – SNB, official sector representative |

1. Introduction

- The two co-chairs of the National Working Group on CHF Reference Rates (NWG) welcomed all attendees to the seventeenth meeting. At the last meeting, the main recommendations were: a) to promote market participants to review their operational readiness, b) to encourage trading in the SARON swap market, c) to promote market participants to review their Credit Support Annex (CSA) and to replace TOIS fixing by SARON, and d) to promote clearing houses to adjust their price alignment interest (PAI) rate and discounting rate to SARON. The aim of the seventeenth NWG meeting was to review the overall progress of the transition from TOIS fixing to SARON, give an update on Libor developments and to recommend SARON as the alternative for CHF Libor.

2. Update on TOIS transition

- Meeting participants were updated on the TOIS transition. The SARON swap market has been established and key market participants are operationally ready.
- The two clearing houses present at the meeting (Eurex Clearing and LCH) announced that they will be changing their PAI rate in respect of CHF denominated swaps from TOIS fixing to SARON and their discounting curves to refer to SARON based instruments this October.¹ In addition, subject to regulatory approval, SARON swaps will be eligible for clearing.²
- LCH has also removed all outstanding SwapClear Contracts which have a contractual reference to the TOIS fixing as of 30 September 2017, and such contracts are no longer eligible for clearing. This removal was effected with the support of interested parties on a voluntary and negotiated basis, although LCH was in a position to close-out remaining open positions should that have been necessary. Eurex will remove all outstanding TOIS contracts by 4 December 2017.
- NWG members discussed the proposal for remaining TOIS contracts with a maturity date beyond 2017. The proposal consists of a recommendation that remaining TOIS contracts be restricted to reference SARON, leaving all other terms (spread, maturity, fixed rate) unchanged. The main reason for this being that these basis swaps are primarily used to hedge basis risk exposures resulting from cash-collateralized derivatives. This basis risk will also change with the change of the PAI for collateralized derivatives from the TOIS fixing to SARON. In case a restrike cannot be agreed on, it was discussed as to whether an alternative recommendation to terminate these trades early prior to 29 December 2017 at the prevailing market value and novate them with a SARON swap that has a zero present value at inception should also be made. Meeting participants decided to recommend only a restrike.

¹ With effective date 9 October 2017 for Eurex Clearing and 16 October 2017 for LCH.

² A few days after the meeting, SARON swaps became eligible for clearing by both clearing houses.

3. Future of Libor

- Meeting participants were provided with a brief summary on the international reform process regarding Libor alternatives:
 - In June, the Alternative Reference Rates Committee (ARRC) selected a broad Treasuries repo financing rate as its preferred alternative.³
 - In July, Andrew Bailey, chief executive of the Financial Conduct Authority (FCA), gave a speech on the future of LIBOR.⁴ The FCA, in agreement with central banks and regulatory authorities, intends after 2021 to no longer persuade, or compel, banks to submit to Libor. Therefore, work must begin on planning transition to alternative reference rates that are based on transactions.
 - In September, the European Central Bank (ECB) announced that they will develop and administer a new unsecured overnight rate. The new rate will be introduced before 2020.⁵ Simultaneously, the Financial Services and Markets Authority, the European Securities and Markets Authority, the ECB and the European Commission announced the launch of a working group tasked with the identification and adoption of a risk-free overnight rate as an alternative to current benchmarks.⁶
- Meeting participants were informed on International Swaps and Derivatives Association (ISDA) working groups on Libor fallbacks that would apply in the event that Libor is permanently discontinued. Progress is being made, with the objective of drafting robust fallback arrangements for new contracts and a future protocol to amend existing contracts to include those fallback arrangements.
- NWG members recommended SARON as the alternative for CHF Libor. SARON covers, by far, the most liquid segment of the CHF money market, is based on actual transactions and binding quotes and follows the International Organization of Securities Commissions (IOSCO) Principles. The potential of unsecured alternative rates has been extensively analysed by the NWG (with negative outcome).
- For the ongoing work NWG members decided to form two sub-working groups to examine CHF Libor-based product types and dependencies. The “retail and corporate market” sub-group will focus on the loan and deposit segment and the “wholesale market” sub-group on derivatives and capital market instruments. After formulating the “terms of reference” of each group the main task of both groups will be to develop a timeline and transition approach.

³ Cf. <https://www.newyorkfed.org/arrc/announcements.html>.

⁴ Cf. <https://www.fca.org.uk/news/speeches/the-future-of-libor>.

⁵ Cf. <http://www.ecb.europa.eu/press/pr/date/2017/html/ecb.pr170921.en.html>.

⁶ Cf. <https://www.esma.europa.eu/press-news/esma-news/new-working-group-risk-free-reference-rate-euro-area>.

4. Recommendations

Based on the earlier discussion, NWG members agreed to issue the following recommendations:

- Regarding the transition from TOIS fixing to SARON
 - To promote market participants to review their operational readiness
 - To promote market participants to be active in the SARON swap market
 - To promote market participants to review their CSA and to replace TOIS fixing by SARON
 - To notice the guidance on TOIS transition
- Regarding the future of Libor
 - To recommend SARON as the alternative for CHF Libor
 - To consider the probability that Libor might not exist beyond 2021
 - To promote planning a transition away from CHF Libor

5. Next steps and organisational issues

- The next NWG meeting is scheduled for Thursday, 11th January 2018, 2:00 pm – 4:00 pm. Personal attendance is highly appreciated, but it will also be possible to dial in by phone.
- Two sub-working groups will be established until the next NWG meeting. All interested parties are requested to inform Matthias Jüttner (matthias.juettner@snb.ch) about their interest in participating.