

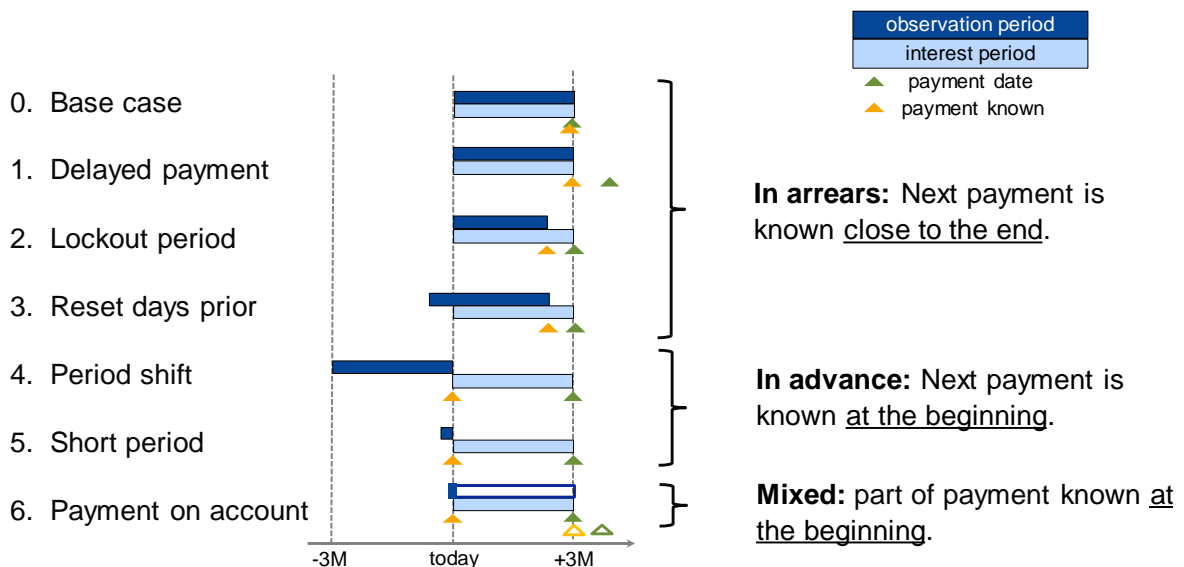
Zurich, 6 February 2019

Executive summary of the 5 February 2019 meeting of the National Working Group on Swiss Franc Reference Rates

The National Working Group on Swiss Franc Reference Rates (NWG) met on 5 February 2019 to discuss current challenges in respect of the LIBOR transition in Switzerland and relevant international developments (see meeting agenda below). At its previous meeting in [October](#) last year, the NWG recommended using a compounded SARON as a term rate alternative to the CHF LIBOR wherever possible.

The key item of yesterday's meeting was to discuss the options for using a compounded SARON in cash products. The Loan and Deposit Market sub-working group identified and described a set of options (see Figure 1). Depending on the need for cash flow certainty, an 'in arrears' or an 'in advance' option may be best suited.

Figure 1: Options for using a compounded SARON in cash products



The Capital and Derivatives Market sub-working group analyzed different compounded SARON options for the use in floating rate notes (FRNs), with a preference for the ‘reset days prior’-option. Based on this assessment, the NWG came to the conclusion that there are no impediments to issuing SARON FRNs.

The NWG members agreed on the following main recommendations:

- Market participants should consider and assess the presented options for using a compounded SARON.
- Financial institutions should individually define action plans with respect to their product strategy.
- Exchanges are encouraged to facilitate the listing of SARON FRNs.

SIX announced that it would provide daily publication of compounded SARON. Go-live is expected for the second half of 2019.

Furthermore, in an effort to raise awareness for the LIBOR transition in Switzerland, the NWG invited infrastructure providers to a webinar, to be held on 26 February 2019.¹

The minutes of the meeting, including the slide deck containing the details about the discussed options, will be published in due course on the [NWG website](#).²

¹ Interested infrastructure providers can register for the event via nwg@snb.ch. Further details on the webinar will be provided to the registered participants in due course.

² The National Working Group on Swiss Franc Reference Rates is the key forum for considering proposals to reform reference interest rates in Switzerland and discussing the latest international developments. NWG recommendations are not legally binding. The NWG is co-chaired by a representative of the private sector and a representative of the SNB. The SNB supports the work of the NWG and acts primarily as a moderator. Furthermore, the SNB runs the NWG’s technical secretariat and facilitates the organization of the NWG meetings.

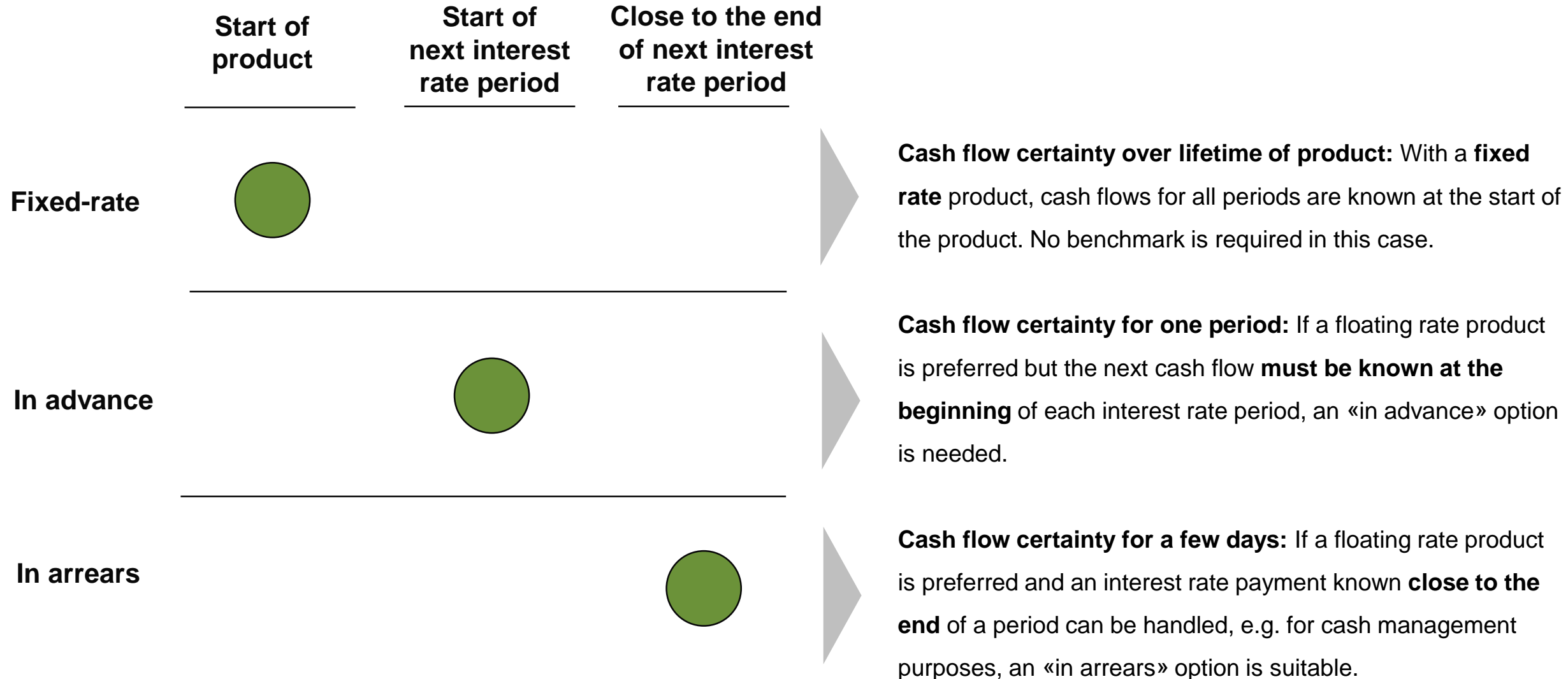
Agenda

1. Opening remarks
2. General update
3. Fallback language: update on ISDA consultation
4. Compounded SARON for cash products
5. SARON based derivatives products
6. Effects on financial reporting: open issues
7. Raising awareness among infrastructure providers
8. Communication
9. Recommendations
10. Next steps

Summary on compounded SARON loan options

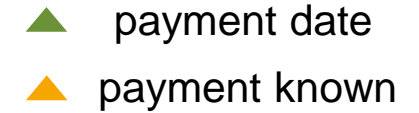
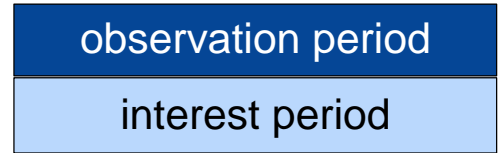
- Several options (0-6) developed, described and assessed
- Some options provide a higher cash flow certainty, but are more complex
- No recommendation for a specific option is given
- Market participants should consider and assess the options
- Financial institutions should individually define action plans with respect to their product strategy

Preferences for cash flow certainty

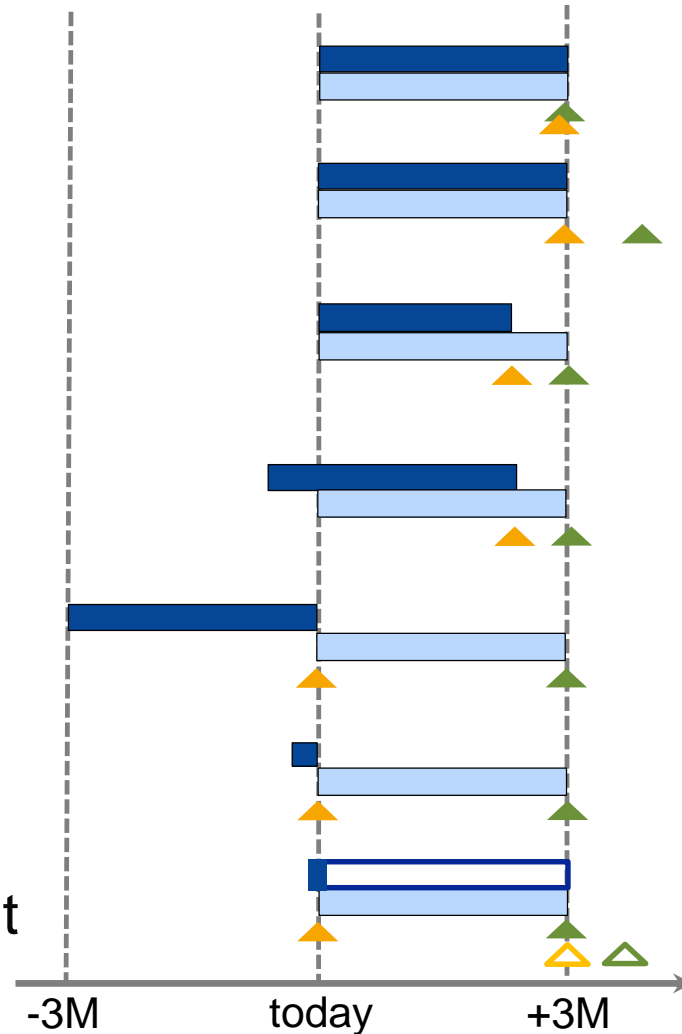


Options for using a compounded SARON

Each figure shows the timing of an interest rate payment



0. Base case
1. Delayed payment
2. Lockout period
3. Reset days prior
4. Period shift
5. Short period
6. Payment on account

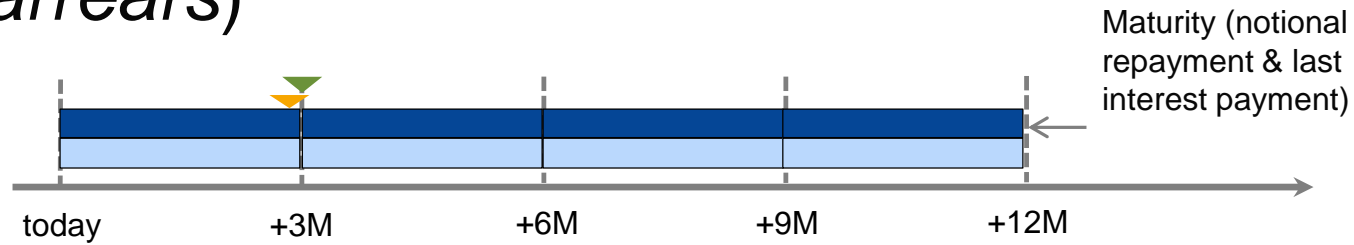


In arrears: Next payment is known close to the end.

In advance: Next payment is known at the beginning.

Mixed: part of payment known at the beginning.

Base case (*in arrears*)



observation period
 interest period
 ▲ payment date
 ▲ payment known

Description

Client value proposition

- Floating rate loan based on SARON (6 p.m.), a robust, risk free, reliable and Swiss CHF benchmark that is compliant with international market standards
- Transparent pricing / rollover
- Simple product structure (compared to other product options)

Client interest calculation

- SARON compounded (resetting e.g. 3M) + contractually defined margin
- Webpage by SIX (administrator) to verify calculation

Cash flows: notional & interest rate

- Notional: Paid out at start of the contract; paid back at the end of the contract
- Interest rate: Paid at the end of each interest rate period

Cash flow certainty

- One day before the end of the interest period at 6 p.m.
- Only indicative amount possible prior to that

Risk disclosure

Interest rate risk and cash flow uncertainty should be disclosed to client

Early termination

Overnight structure allows for early termination on short notice

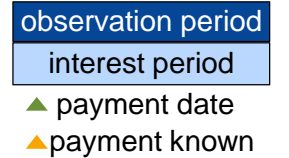
IR risk transfer

Possible on deal and portfolio level (cash flow mismatch as swap market uses a delay of two days)

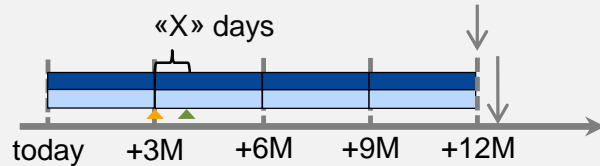
Other

No conflict with accounting, tax and legal (for all options) identified. However, each bank should assess individually.

Overview of further in arrears options

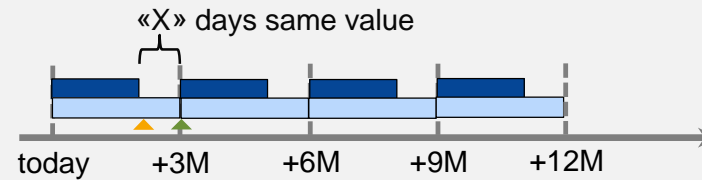


Delayed payment



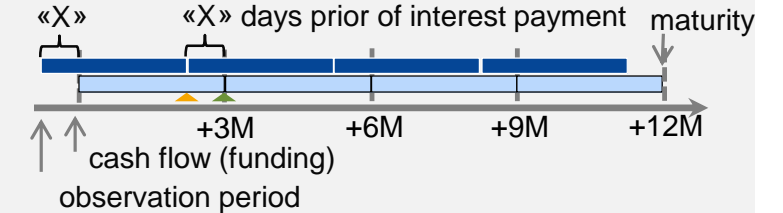
- Client payment is delayed by X days after end of interest period, to allow for better operational cash flow management
- If $X = 2$, the cash flow of the loan matches the interest rate cash flow of SARON swaps
- In last interest period, interest payment after payback of notional (incl. release of collateral), i.e. mismatch of cash flows and increased credit risk

Lockout period



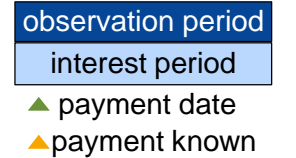
- Actual SARON fixings are used until X days before the end of the observation period. For the last X days, SARON is no longer refreshed (lockout period)
- Interest rate calculation becomes less transparent for clients and more complex for banks to implement
- Slightly increased interest rate risk due to rate changes during lockout period. It can be hedged if required

Reset days prior

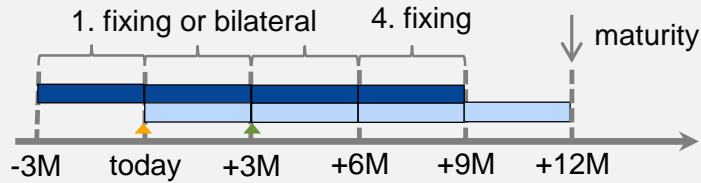


- Observation period starts and ends X days prior to the relevant interest rate period
- Slightly increased interest rate risk due to changes in the yield curve over the lifetime of the product. It can be hedged if required

Overview of in advance options

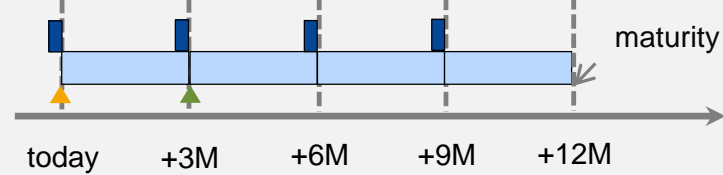


Period shift



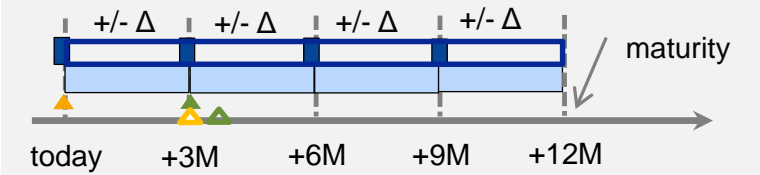
- Client payment equals SARON compounded from previous period, plus a mark-up to compensate for the missing last observation period
- Client knows cash flows at the start of each interest period
- Early termination becomes more complex as most likely some sort of compensation mechanism is needed
- Due to the period shift cash flows of swap and loan have a mismatch, which increases hedging complexity

Short period



- SARON or X days of SARON compounded are fixed for whole interest period and paid at the end
- Client knows cash flows at the start of each interest period
- Bank takes the interest rate risk
- SARON is more volatile than SARON compounded

Payment on account




- SARON or X days of SARON compounded are fixed for whole interest period and paid at the end
- Further, a delta to compounded SARON known at the end of each period is paid X days after interest period ends (by either party)
- Only part of interest payment known in advance
- Early termination becomes more complex as most likely some sort of compensation mechanism is needed

Summary on SARON Floating Rate Notes

Work done by the Derivatives and Capital Markets Sub Group

- Concluded on key features of an SARON FRN
- Assessed different options on how to use a compounded SARON and established a preference for “reset days prior” and “lockout period” – in that order of preferences
- Drafted key elements of a fallback language (if SARON were to discontinue)
- Confirmed feasibility with SIX and identified the need to implement only one type of interest rate provisions, i.e. reset days prior; SIX is working on the implementation
- Concluded that the offset of 5 days seems appropriate

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- There are no impediments to issuing SARON based FRNs
 - Exchanges are encouraged to facilitate the listing of SARON based FRNs

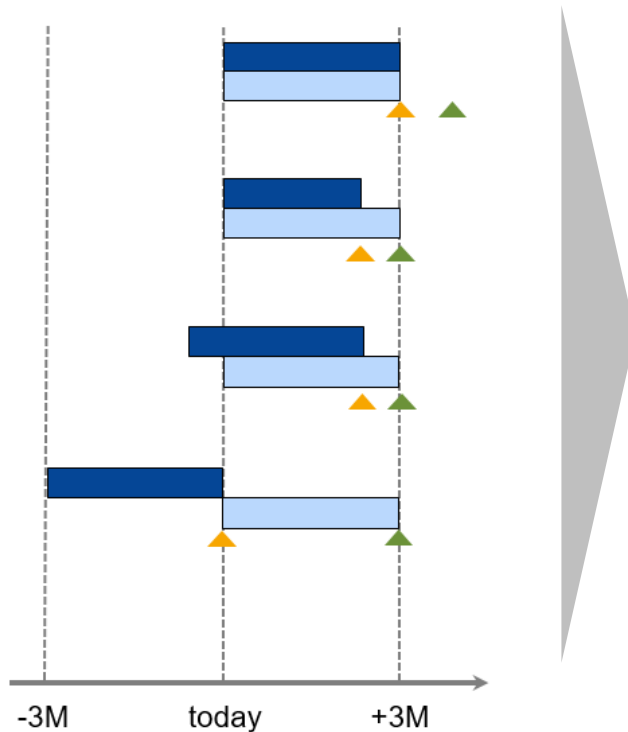
Next step

- Finalize a standard for fallback language for SARON FRN

Challenges with FRNs and ways to address them

- Coupon determination for RFR FRN (in arrears) is materially different than for IBOR FRN (in advance)
- Issuers, paying agents and exchanges require a number of days for processing between the determination of the interest rate and the payment of the coupon

There are different approaches for interest rate provisions to address this matter



Assessment

1. Delayed payment: Diverging dates for notional repayment and last interest rate payment (not preferred)
2. Lockout period: Suffers from volatility of SARON or rate changes during the lockout period (second preference)
3. Reset days prior: Suffers from volatility of yield curve, but economic impact is small and hedging is simple (first preference)
4. Period shift: Complex to hedge (not preferred)

Summary of preferred FRN provisions

Interest rate determination

- **Reset days prior:** The advantages of this approach outweigh some of its small inherent economic drawbacks
- A **time lag between 3-5 days** is deemed to be sufficient to deal with operational matters. **5 days seem appropriate** as the weighting of weekends does not change, is also applied in other jurisdictions, and may obtain the largest operational acceptance

Compounding vs. weighted average

- **Compounding** (to match swap convention)

Business day convention

- **Modified following** (to match swap & cash markets)

Day count fraction

- **Actual/360** (to match swap & cash markets)

Fixing time

- **18:00** (to match swap market)