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AGAR’s conclusions from consultation 2

Introduction
The Working Group for Alternative Reference Rates (AGAR) is working to develop an alternative reference rate for Swedish kronor. Work is underway in many other countries to establish new reference rates in the form of nearly risk-free rates (RFRs) after this was recommended by the Financial Stability Board in 2014. A nearly risk-free rate of this kind was defined by AGAR last summer following a consultation¹.

This consultation has now been followed up with a further consultation. This second consultation from AGAR addressed the issue of the transition from one interest rate system to another. This document describes the conclusions AGAR has drawn from this consultation. These are therefore the decisions that AGAR will be making on these issues in this situation.

Eight organisations responded to this consultation. Many of the respondents were professional associations and may be considered representatives of their industries. There is generally not much variation in the responses.

Description of the scenario
The responses received show that everyone agrees with the main features of the scenario described by AGAR in the consultation. There are two minor differences, which are described below.

AGAR makes the general assumption that Stibor will continue to be the main reference rate in Sweden. There has been no distrust of Stibor expressed either in the responses to this consultation or in any other way. AGAR believes it is important that there remains a high level of confidence in Stibor, both on the market and among supervisory authorities and central banks. There is no reason at present to doubt that this confidence remains high. One respondent thought that AGAR should consider a greater likelihood that Stibor in its current form will not be approved under the BMR². AGAR nevertheless considers that everything is being done in order for Stibor’s administrator

¹ https://www.swedishbankers.se/media/4311/definition-of-interest-rate-decision.pdf
² Benchmarks Regulation (EU) 2016/1011
to be approved under the BMR and that Stibor will comply with the regulations of the BMR and therefore also become an approved benchmark in accordance with the BMR.

The new nearly risk-free rates (RFRs) being established in many countries will increase in importance going forward, although they will co-exist with traditional interbank rates (Ibors). AGAR does not believe that the RFRs will take over globally within the foreseeable future. On the other hand, much points to that those countries which use Libor will move to using different RFRs as their main reference rates after 2021. It nevertheless appears that Euribor and the Ibors of a number of smaller currency areas will continue to exist. This means it is important that to establish an RFR for SEK but it is not necessary for all financial contracts to replace their reference rate with the new RFR within the foreseeable future. There will be two different interest rate systems on the global financial market for a period. For Sweden’s small, export-dependent economy to be able to handle this, it is important that both types of interest rates can be used in the country. One respondent thinks that RFRs will spread across the world more quickly than AGAR described in Consultation 2.

The main benefit of the new RFR, other than representing a potential alternative, will be in acting as a fallback solution in contracts that refer to Stibor. This can be used to provide a more robust solution of how to handle situations if Stibor were to be discontinued, rather than referring to ‘cost of funds’ or similar. It will also then be possible to create fallback solutions that are used in ISDA contracts and other types of international contracts where standards for more robust fallback clauses will be required. Of course, such more precise fallback solutions will make things easier if Stibor were to be discontinued.

Standards and conventions
The general message is clear that the respondents want standards to be developed around the new interest rate to make it easier to manage. Most emphasise the need to develop solutions that are not uniquely Swedish but are instead rooted in international standards. Several also name ISDA as a standards body.

AGAR does not disagree with this general conclusion. The problem, however, is that most working groups in larger currency areas and other standards bodies have focused strongly on what ISDA has done in relation to these issues and have decided to follow what ISDA comes up with. What ISDA has been working on mainly are fallback solutions. These solutions have contained details on how compound rate should be calculated, how to handle observation periods, lags, freezes and other things related to conventions for formulating a useful compounded rate. Time has also been spent considering what will trigger a change in reference rate and how such a change should take place. Finally, ISDA has also worked on developing methods for calculating the
Credit Adjustment Spread. Overall, this means that ISDA has now established many of the elements necessary in order to develop standards for using the new interest rates³.

ISDA having developed the elements for designing various aspects of standards is not the same as real standards having actually been created. It is clear that these can be used for derivatives, in particular in the currency areas that ISDA has discussed. However, these do not represent finalised standards on how this should work for other products and in other currency areas. A little more international work may be required before conclusions can be drawn on how these standards should be used for other products in Sweden.

AGAR will take steps to develop standards for fallbacks for products regulated by the BMR which currently use Stibor. The basic principles for these will be taken from ISDA. Ideally, the fallback solutions should be as similar as possible, whatever the product.

There is no support among the respondents for AGAR to do anything to encourage the use of the new RFR. This must come from the demands of the market. For example, no derivatives market or similar needs to be established until there is a demand for these services.

Many respondents think it would be a positive step if the administrator could publish one or more compounded rates. This would help to create standards for calculating these interest rates in the market. AGAR will pass this request on to the future administrator of the new interest rate. There will also be a link between this request and the principles for compounded calculations, which ISDA has established and which will also in general be expressed by AGAR.

The respondents expressed their appreciation if standards could be developed for the details around what could provide the basis for calculating interest in terms of the average calculation method, payment date, freezing and lag. This is to enable standards to be implemented not only in the derivatives market but also in the bond and loan markets. If these principles are expressed in the context of designing fallbacks, they should be consistent with what subsequently applies in the markets for these instruments when the RFR comes to be used as the main reference rate.

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