2023-09-01

Project 3: Consultation on interest rate swaps

# Introduction

The purpose of this consultation is to find out how the market would react to a switch from the tenor STIBOR T/N to SWESTR, if STIBOR T/N were to cease to be published and market participants would use SWESTR instead of STIBOR T/N. The consultation also aims to get an idea of the most suitable solutions for how such a switch could take place. The consultation is not about whether STIBOR T/N should cease to be published or not, but only about how a possible change could take place. Any decision to cease publication of STIBOR T/N can only be made by its administrator (Swedish Financial Benchmark Facility, SFBF) or its supervisory authority (Swedish FSA, Finansinspektionen).

We would like you to send your answers to info@swedishbankers.se by September 29 at the latest. Should you have any questions or want to discuss something in the consultation, please contact jonny.sylven@swedishbankers.se.

# Background

For some time now, many countries have been working on developing alternative reference rates. Among other things, it has been about replacing Ibors[[1]](#footnote-1) in the currency areas where that reference rate was used with new risk-free reference rates (RFR). These new reference rates have consistently been O/N rates with a maturity of one trading day only. Even in currency areas where it has been chosen to keep Ibors as the main reference rate, RFR-rates have developed. Sweden has SWESTR, Euroland has developed €STR, Norway has NOWA and Denmark has developed DESTR. When the Swedish banks developed the recommendation into what is today SWESTR, STIBOR T/N was not considered necessary when an O/N rate was to be established. Using the responses from this consultation and collaboration in the market, the aim is to explore how such a switch could be implemented.

# Use of STIBOR T/N

STIBOR T/N is used today to a very small extent as a reference rate in financial contracts. However, there are some financial contracts that refer to STIBOR T/N, for example certain types of deposit accounts and the reference rate can also be used in CSA agreements (Credit Support Annex). There is a derivatives market based on STIBOR T/N called the STINA market. It is an OIS market based on STIBOR T/N that can be cleared via Nasdaq and traded bilaterally. The turnover in this market is small and sporadic and there is very little to indicate that this market is important for Swedish actors.

However, STINA OIS swaps fulfil a function in that the interest from these instruments is used to discount cash flows in derivative contracts and thereby calculate, among other things, the present value (PV) of cash flow. These present values also form the basis for calculating variation margin (VM) requirements between counterparties in CSA agreements or at clearing houses such as Nasdaq.

The reason why STINA is used is that STIBOR T/N is often used as a reference rate on collateral denominated in SEK, either in bilateral CSA agreements or in the form of PAI (Price Alignment Interest) at clearing houses. Users of interest rate derivatives in Swedish kronor may for this reason, even if they only trade derivatives tied to 3m STIBOR, come to use calculations based on STIBOR T/N for example valuation or risk measurement as well as for accounting and reporting.

The use of STIBOR T/N or STINA rates can be summarized with the following image:



What distinguishes STIBOR T/N from the other STIBOR maturities is the last part, which does not really refer to the normal, in the legal sense, use of reference rate in financial contracts, but which can nevertheless affect economic valuations for various actors in the financial system. There are probably no fallback clauses for replacement rates in these agreements. A switch also affects actors' system technical infrastructure, which is often complex. Time is probably needed to come to terms with these aspects.

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| Question 1: Do you use STIBOR T/N in any way that is not stated above? In such cases, please explain whether a lack of STIBOR T/N as a reference rate or a change to another reference rate such as SWESTR could affect you and in what way. |
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# Perception of SWESTR

SWESTR is the RFR that the Riksbank administers and publishes daily on its website.[[2]](#footnote-2) The basis for this reference rate was developed by the Swedish banks through the AGAR working group in 2019. This work was carried out to produce a risk-free O/N reference rate that is as similar as possible to the reference rates that other countries have developed (€STR, SONIA, SOFR, SARON). The Riksbank has, on a number of points, disregarded or chosen not to implement the banks' proposals. SWESTR also differs on a few points from its international counterparts. In order to gain acceptance for SWESTR, the Swedish Bankers’ Association has therefore expressed that it would be desirable for SWESTR to be harmonized with the working group AGAR's original proposal.

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| Question 2: Do you consider that SWESTR in its current state is suitable for use in financial agreements? If not, what do you think needs to be improved regarding SWESTR for the interest rate to be a robust reference rate that can be used in financial contracts? |
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# Timetable for the implementation of any replacement

In the work that has been done internationally regarding the exchange of reference rates, it has been shown that it is of great importance that there is a clear timetable for when the exchange of reference rates can take place.

In a possible switch of STIBOR T/N to SWESTR, there are at least three points in time that are important.

1. Timing of publication of the entire timetable and method: An official timing of when STIBOR T/N will cease to be published must probably be stated. This procedure is regulated by law. According to the Benchmark Regulation[[3]](#footnote-3), only the administrator of STIBOR T/N (SFBF) or its supervisory authority (Finansinspektionen) can make such an announcement.
2. Time when it is no longer appropriate to sign new agreements with reference to STIBOR T/N. After this date, it will still be possible to make valuations of interest derivatives and calculate, for example, risk using STIBOR T/N. It must be possible to use STIBOR T/N for this as there will be outstanding contracts.
3. Time of possible cessation of publication of STIBOR T/N. Hopefully, all agreements with reference to STIBOR T/N have been negotiated before this date. If the relevant agreement has clauses on fallback rates that follow the Swedish Bankers’ Association's recommendation,[[4]](#footnote-4) there is the possibility to follow that recommendation and change the interest rate in connection with the last interest period. Likewise, a change of reference rate for the calculation of collateral requirements to clearinghouses or according to the CSA may have been decided before this date, but not later. How this is to be done must be agreed upon by the contracting parties. All internal models for valuation and risk should also be changed before this date.

Depending on the choice of method, there may also be a need for a specific time when STIBOR T/N will be redefined, when the clearinghouses will make changes to their valuation models and when bilateral agreements, which contain similar valuation models, will be renegotiated.

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| Question 3: Do you think this is a fair description of what needs to be done over time or is there something missing? |
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It is possible to see how these events regarding the change of reference rates could be distributed over time:



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| Question 4: How much time do you think you need between the time for the publication and the fact that it will no longer be possible to sign new agreements? Justify your answer. |
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| Question 5: How much time do you think you need from when it is not appropriate to sign new contracts and STIBOR T/N stops being published? Justify your answer. |
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| Question 6: Changes to the calculation basis for collateral should follow an agreement between the parties. Do you think it would help if the Swedish Bankers’ Association made a recommendation to its members about how this should be handled? |
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# Method of exchange of interest

There are basically two methods of changing reference rates. Both methods assume that there is an official opinion that STIBOR T/N will cease to be published at some point in the future. In the following, these two methods have been supplemented with a variant.

1. The parallel method: a new market for SWESTR is established in parallel with the existing one. This mainly applies to a new OIS market based on SWESTR being established while the existing STINA market remains. But it also means that derivatives on the new market can be discounted, and risk managed using the interest rate curve from the new SWESTR-based market, while the STINA market's derivatives and other interest rate derivatives can be managed with the STINA curve. The parallel method is already a fact since there is clearing for SWESTR derivatives at LCH and Nasdaq.
2. The redefinition method: Since an OIS market has already been established, one method could be to redefine STIBOR T/N to SWESTR plus a spread and allow existing contracts to continue in this market with a "SWESTR plus spread" instead of STIBOR T/ N, while new contracts are signed in the SWESTR market and with reference to SWESTR.
3. Variant of the parallel method: Since it is probably not that common for financial contracts to contain wording about what happens when the reference rate ends (fallback clauses), most agreements will have to be renegotiated. There are probably no such fallback clauses in the CSA agreement or in the membership agreement for the clearing houses. The Swedish Bankers’ Association could come up with a recommendation that the renegotiations should strive to achieve that STIBOR T/N should be equal to SWESTR plus a spread, based on what has been stated in the existing Swedish Bankers’ Association recommendation regarding a fallback rate for Stibor. It states that the spread should be the median of the difference between STIBOR T/N and SWESTR over the past five years.

There has been criticism of the Parallel Method that it will not push for a transition to the new interest rate. The redefinition method does not give the parties any choice. However, the redefinition method will lead to the entire process taking time because a change to the method requires a legal process involving an authority decision by the Financial Supervisory Authority.

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| Question 7: Which method of transition do you prefer? Please state how you argue, why you prefer your alternative and why the other alternatives are not recommended. Since there are already parallel markets, we ask that you only indicate how this can be handled in the most appropriate way, also considering other uses of STIBOR T/N (valuation) and occurrence of STIBOR T/N in other types of agreements. |
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| Question 8: Do you see any other alternative method of transition or a combination of the proposed alternatives? |
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# Economic aspects of changing the reference rate

When changing the reference rate in a financial agreement, value transfer between the parties may occur. To counteract that, standards have been drawn up to eliminate risks of value transfer. The most comprehensive standard available is the one developed by ISDA for Ibors to RFR. This is based on a spread adjustment being determined as the median of historical observations of the daily spread over a five-year period of historical interest rates, which is set relative to the time when STIBOR T/N should be replaced in the future.

The principles in ISDA's standards have been used when the Swedish Bankers’ Association drew up its recommendation regarding a fallback. The principles presented in that recommendation can be used in agreements where a fallback rate has not been agreed upon.

The Swedish Bankers’ Association's recommendation means that the replacement rate should be an adjusted RFR, with the same observation period as the IBOR to be replaced, plus a spread adjustment. However, STIBOR T/N, the recommendation states that no adjustment takes place, but only SWESTR is used. Bloomberg publishes replacement rates for STIBOR. In its system, Bloomberg has not taken into account that SWESTR and STIBOR T/N have different start times. Thus, the same observation period is not used to obtain spread adjustment.

SWESTR, in its function as replacement rate, must be supplemented with a spread adjustment. The standard used internationally means for the exchange in question that the median of the difference between STIBOR T/N and SWESTR (as above) for the last five years is used. Since SWESTR does not have sufficient history, the Riksbank has reconstructed the history for SWESTR five years back in time in a similar way to other RFR interest rates, e.g., SOFR, €STR, NOVA.

This fallback rate is published by Bloomberg, on behalf of ISDA, and is available delayed on their website, in real time to their subscribers. On their website there are also descriptions of the regulations for how the fallback rate is calculated.[[5]](#footnote-5)

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| Question 9: Do you think that the fallback rate should be calculated in a different way than described above? Justify your answer. |
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| Question 10: Do you think that the Swedish Bankers’ Association should give a more detailed description of how the replacement rate should be calculated than what is stated by Bloomberg? Is further clarification needed regarding daily conventions? Feel free to exemplify what needs to be supplemented. |
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# Other aspects

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| Question 11: Is there anything else to add regarding the method of changing STIBOR T/N to SWESTR? |
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1. Ibors refers to interbank interest rates throughout. For example, LIBOR, CIBOR, NIBOR. [↑](#footnote-ref-1)
2. [SWESTR | Sveriges Riksbank](https://www.riksbank.se/en-gb/statistics/swestr/) [↑](#footnote-ref-2)
3. Regulation (EU) 2016/1011 of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds. [↑](#footnote-ref-3)
4. [Recommendation regarding a fallback rate for Stibor | Swedishbankers](https://www.swedishbankers.se/en-us/issues-we-work-with/fallback-rate-for-stibor/recommendation-regarding-a-fallback-rate-for-stibor/) [↑](#footnote-ref-4)
5. [LIBOR Resource Center | Bloomberg Professional Services](https://www.bloomberg.com/professional/solution/libor-resource-center/) In the published rule book, there is information on which calculation methods were used and historical outcomes for STIBOR are published under SEK STIBOR Fallback [↑](#footnote-ref-5)