The Working Group on Sterling Risk-Free Reference Rates

UK Working Group on Risk-Free Reference Rates – Market Infrastructure Sub-Group

Priority List (updated August 2019)

Below is ***the updated*** *priority list with regard to infrastructure developments for the RFR transition in UK markets agreed by the Working Group on Risk-Free Reference Rates 'RFRWG'. This document does not constitute an exhaustive or final list and will be updated on a regular basis with amendments and additional information to reflect ongoing progress on plans for benchmark transition, and further work from the infrastructure sub-group and the RFRWG.*

To provide feedback and comments, please contact RFR.Secretariat@bankofengland.gsi.gov.uk

Key:

High priority item with planning and analysis still to be commenced in certain areas

Medium priority item with more planning, analysis and delivery required

Low priority item with some planning, analysis and delivery required

1. Infrastructure Information and analytics

a. Publication of SONIA compounded over standard interest periods, as an accrual and as a final rate, on a daily basis and a calculator to calculate the rate

b. Analytics on SONIA bonds, loans, repos, swaps, swaptions, cap/floors, cross-currency swaps, etc.

c. Broker screen or third-party-provided data source for all SONIA products (e.g. data source could include historical data, trends and comparisons of compounded SONIA vs. base rate vs. LIBOR)

Update – Benchmark administrators have confirmed they are working on the development of Term Sonia Reference Rates (TSRR), and each delivered a short factual presentation to the RFRWG.[1] A discussion on structured products highlighted additional infrastructure concerns e.g. a need for further OIS fixing rates (including at longer maturities) to support a move to RFRs for constant maturity swap (CMS) linked products and swaptions. CMS-linked structures with payoffs in two currencies would need fixing rates in both currencies.

[1] https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/statement-on-the-progress-on-adoption-of-risk-free-rates-in-sterling-markets

2. Bonds processing

In general updates are required to systems including payment and clearing systems; treasury management systems; ALM systems; financial reporting systems; and trading platforms. In particular:

a. Ability for front office ‘FO’ (trading, syndication, repo, etc.) buy and sell-side systems to perform calculations (including risk analytics) for FRNs linked to SONIA

b. Ability for back office ‘BO’ settlement, accounting, reporting and clearing systems for the buy and sell-side to calculate accruals, P/L and settlement values

c. Ability for bonds trading platforms and exchanges to accommodate SONIA FRNs

d. Ability for issuers to calculate, accrue and manage SONIA FRNs

Update – There has been active securitisation and issuance with over 40 sterling bond issues referencing SONIA, total value of c. £29bn to date. Initial indications are that systems are able to manage front-to-back capture, pricing and settlement with some development; tactical support for processing exists until development prioritisation is delivered.

3. Loans processing

In general updates are required to systems including payment systems; treasury management systems; ALM systems; financial reporting systems; and trading platforms. In particular:

a. Ability for FO trading, syndication and management systems to perform calculations for loans linked to SONIA

b. Ability for BO settlement, servicing and accounting systems to calculate accruals, P/L and settlement values through an automated approach resulting in little/no manual processing

c. Ability for loan trading platforms to accommodate SONIA loans

d. Ability for issuers to calculate accruals and settlement values for SONIA loans

Update – A working document on loans processing has been published, outlining the infrastructure considerations for the transition from LIBOR to SONIA, and the RFRWG has published a summary of feedback on conventions for use of compounded SONIA.[2] Development will need to proceed rapidly, so feedback is encouraged to affirm or highlight additional issues where they exist.

4. Derivatives processing

a. For swaps referencing Libor there is a limited systems overhead required to support customisation of reset lags. In general, this is not the case for swaps referencing SONIA whenever there is a deviation from the market standard, e.g. customizing accrual and settlement dates on a SONIA swap to match cash flows of an underlying asset. In these cases there can be a substantial overhead of system changes. Technology providers need to account for this when providing solutions to their customer base.

b. Clearing eligibility for SONIA swaps with various payment frequencies (such as quarterly or semi-annual)

c. Ability of FO systems to execute, transact OTC derivatives for all derivatives products linked to SONIA (such as IRS, cross-currency swaps, swaptions, cap/floors)

[2] https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/statement-and-summary-of-responses-to-sonia-conventions-discussion-paper.pdf

d. Ability for BO systems to account for, report, settle and manage all SONIA-linked derivatives

e. Utility to perform multilateral bulk indexation change from LIBOR to SONIA

f. Utility to perform an indexation repapering for existing derivative contracts

Update – As noted above, OIS fixings for SONIA linked swaps would be required for the development of new CMS market and help with the transition of existing CMS trades.

5. Treasury and asset liability management systems

a. System and accounting ability to base fund transfer pricing on SONIA

b. System and accounting ability to manage the interest-rate risk in the Banking books (IRBB) using the SONIA curve and SONIA instruments

c. System and accounting ability to base intercompany funding and external funding on SONIA

d. System ability to manage hedge accounting under IAS39 and IFRS9 (There needs to be an economic relationship between the hedged item and hedging instrument to claim hedge accounting)

e. Ability for systems to forecast cash flows

Update – Focus on industry groups and trade associations to be targeted to engage on treasury challenges to RFR adoption and transition from LIBOR. Most treasury management system (TMS) providers are aware of SONIA and have plans to support corporate clients but are awaiting the final conventions before developing solutions. While there is concern of the impact of the different conventions for the other RFR currencies, some system providers are already beginning development.

6. Risk Management and Valuations

a. System changes to incorporate the impact on pricing and risk management models including curve construction, discount curves and pricing implications for SONIA-related products such as CCP discounting, observable volatilities in multiple indices of the same currency and valuations

b. System changes to handle the proposed increase in time between fixing date and publication date for legacy LIBOR transactions post-2021

c. Systems to incorporate accurate historical data sets for risk models (VaR, Counterparty Exposure PFEs, risk-based margining, FRTB)

d. Systems to incorporate changes to risk calculations impacting regulatory capital

Update – Systems should be able to measure Libor specific risk for individual instrument types and be able to differentiate between net Libor and actual Libor exposure.

7. Other

a. Ability for systems to manage trade finance indexed to SONIA

b. Ability for systems to manage retail investment products indexed to SONIA

c. Ability for systems to benchmark fund performance on SONIA

d. Ability for systems to manage the regulatory impacts related to SONIA on EMIR/MIFID 2 /MIFIR e.g. reporting

Update – An event titled 'Last Orders: Calling Time on LIBOR' was held at the Bank of England 5th June 2019, highlighting the need for firms to accelerate their transition away from LIBOR – event material can be viewed here. One item of interest was the 'Dear CEO Thematic Feedback' which highlights 8 key findings that all firms should consider whilst planning for the cessation of LIBOR.