

Minutes from the meeting of the National Working Group on CHF Reference Interest Rates (4 June 2018)

Attendees:

Martin Bardenhewer	– Zürcher Kantonalbank, co-chair
Marcel Zimmermann	– Swiss National Bank, official sector representative, co-chair
Philipp Ackermann	– Raiffeisen Switzerland
Uriel Amitai	– Intercontinental Exchange (by phone)
Pascal Anderegg	– Zürcher Kantonalbank
Christian Bahr	– SIX Swiss Exchange, SRR administrator
Markus Bieri	– Swiss Association of Corporate Treasurers
Marie-Anne Bourgoz Gorgé	– Banque Cantonale de Genève (by phone)
Marco Brück	– Valiant
Beat Cavegn	– Cosmorex (by phone)
Christophe Cherdel	– Banque Cantonale Vaudoise (by phone)
Andreas Franke	– Eurex Clearing (by phone)
Kilian Frensch	– Association of Foreign Banks in Switzerland (by phone)
Guillermo De La Fuente	– Association of Corporate Treasurers - Suisse Romande (by phone)
Beat Gabathuler	– Zürcher Kantonalbank
Fernando Gardoni	– St. Galler Kantonalbank
Jürg Gasser	– Cosmorex (by phone)
Christian Gerber	– Axa
Raffael Goldenberger	– Entris Banking
Sacha Guillemain	– Association of Corporate Treasurers - Suisse Romande
Stephane Hegi	– Banque Cantonale Vaudoise (by phone)
David Horner	– LCH
Otto Huber	– Credit Suisse, chair Sub-NWG D&C
Jenny Ivleva	– Deutsche Börse
Roger Kleis	– Graubündner Kantonalbank
Colt Lake	– UBS
Alfred Ledermann	– UBS, chair Sub-NWG L&D
Ernst Lienhard	– Swiss Re
Jon Lindholm	– SIX Group
Kam Mahil	– Loan Market Association (by phone)
Bruno Marin	– BNP Paribas
Jonathan Martin	– International Swaps and Derivatives Association
Stefan Pomberger	– Bank Vontobel
Felix Roudier	– Credit Suisse
Martin Scheck	– International Capital Market Association
Daniel Schenker	– Zürcher Kantonalbank
Thomas Schulthess	– Bank CIC
Christian Schwyn	– Basler Kantonalbank
Roland Studer	– Credit Suisse
Thomas Sturzenegger	– Julius Bär
Pierre-Henri Turc	– Banque Cantonale de Genève (by phone)
Hugues Weil	– Credit Suisse
Philip Whitehurst	– LCH
Nicolas Graafen	– State Secretariat for International Finance, official sector representative
Stefan Kurt	– Swiss Financial Market Supervisory Authority, official sector representative
Roman Baumann	– Swiss National Bank, official sector representative
Basil Guggenheim	– Swiss National Bank, official sector representative
Silvio Schumacher	– Swiss National Bank, official sector representative
Surya Singh	– Swiss National Bank, official sector representative

1. Introduction

- The two co-chairs of the National Working Group on CHF Reference Rates (NWG) welcomed all attendees to the nineteenth meeting and reminded them of their responsibilities in relation to competition law and confidentiality. The aim of the meeting was to give an update on the international reform process, to discuss the work of the two sub-working groups since the last meeting of the NWG, and to discuss recommendations and next steps.

2. Update on international reforms

- Meeting participants were provided with a brief summary of the international progress on benchmark reforms:
 - IBA published a report on the new waterfall methodology (WA). Libor panel banks will transition to the WA on a gradual basis, in order to minimise operational and technology risks. However, it is likely that certain tenor and currency combinations will cease to exist.¹ The future of Libor beyond 2021 remains an uncertainty, and in light of the results of the waterfall results published by ICE it seems particularly uncertain for CHF. Therefore, the co-chairs re-iterated the need to relentlessly continue the work on alternative reference rates.
 - Since the last NWG meeting in January, there were important developments in other LIBOR jurisdictions. In the Eurozone, the European Money Markets Institute (EMMI) announced that it will not continue the reform of EONIA.² In the US, the New York Fed started publishing SOFR on April 3rd and CME started offering SOFR Futures.³ In the UK, the Bank of England completed the reform of SONIA, and LSE as well as ICE started offering SONIA Futures.⁴
- NWG participants were informed about the current outstanding volume in the SARON swap market, which reached similar levels as the TOIS market in 2016. However, compared to the volumes in the CHF IRS market, the volumes are still small.

3. Derivatives and Capital Market Sub-Working Group⁵

- Derivatives and capital market (D&C) sub-working group members presented a proposal for the specification of 3M and 1M SARON Futures contracts. In order to facilitate the adoption of the new Futures, the contracts should be designed using i) the IMM dates (as in EuroSwiss Futures contracts), ii) the same rate calculation as the OTC market (compounding), and iii) a specification close to that of other Futures referencing to alternative reference rates in other

¹ Cf. https://www.theice.com/publicdocs/ICE_LIBOR_Evolution_Report_25_April_2018.pdf

² Cf. <https://www.emmi-benchmarks.eu/assets/files/D0030D-2018-Eonia%20review%20state%20of%20play.pdf>

³ Cf. <https://apps.newyorkfed.org/markets/autorates/sofr>, <http://www.cmegroup.com/trading/interest-rates/secured-overnight-financing-rate-futures.html>

⁴ Cf. <https://www.bankofengland.co.uk/news/2018/april/sonia-interest-rate-benchmark-reform>, <https://www.theice.com/products/68361266/Three-Month-Sonia-Index-Futures>, <https://www.lseg.com/resources/media-centre/press-releases/curveglobal-launch-three-month-sonia-futures-contract>

⁵ Cf. https://www.snb.ch/en/mmr/reference/tor_dc_subgroup/source/tor_dc_subgroup.en.pdf

jurisdictions (e.g. SOFR and SONIA). NWG members agreed on the proposal of the D&C sub-working group to recommend 3M SARON Futures, but not 1M SARON Futures at this point. NWG members were invited to provide feedback on the specification for 3M SARON Futures by 15 June 2018. After incorporating the feedback, the term sheet was published on the website of the NWG. Exchanges are invited to follow the recommended term sheet and start offering the product accordingly.

- The chair of the D&C sub-working group provided an overview of five different SARON-based methodologies for a CHF reference interest rates with a maturity beyond overnight. The alternatives were grouped into “cash flow approaches” and “term rate approaches”. The chair noted that none of the methodologies is perfect, and that all stakeholders need to consider the trade-offs that are involved when making an assessment of the different alternatives. As a next step, the D&C sub-working group will assess the feasibility of the different term rate approaches, in particular elaborate technical details on infrastructure requirements of a derivatives-based term rate. All market participants are invited to provide feedback regarding the different approaches to nwg@snb.ch.

4. Loan and Deposit Market Sub-Working Group⁶

- The chair of the sub-working group provided an overview of three product scenarios with regard to a transition from CHF LIBOR to SARON: i) the existing book with reference to LIBOR without fallback provision, ii) the new book with reference to LIBOR and fallback provision, iii) the new book with reference to the new benchmark. The current focus is on 2), where the L&D sub-working group is working on a fallback template for standard loan contracts. Potential components of a fallback template include (i) a clearly defined trigger event for fallback activation, (ii) a fallback rate or product alternative, and (iii) an adjustment spread to minimise values transfer in the transition.
- Meeting participants were informed by a representative of the International Swaps and Derivatives Association (ISDA) about the progress in the work on developing fallback language that would apply in the event of a discontinuation of LIBOR. NWG members were encouraged to engage with ISDA in order to be kept abreast of new developments as well as to offer constructive feedback.⁷
- The Loan Market Association (LMA) provided a short update, discussing a recently published revision of its existing Replacement of Screen Rate clause. The revision facilitates further flexibility than the existing clause and allows amendments to be made to facilitate inclusion of a replacement benchmark.
- Meeting participants were updated on the planned corporate client outreach. The aim of the outreach is to understand the preferences of corporate clients for the different approaches (“cash flow” and “term rate approaches”) as well as to understand and raise awareness of the

⁶ Cf. https://www.snb.ch/en/mmr/reference/tor_ld_subgroup/source/tor_ld_subgroup.en.pdf

⁷ Cf. <https://www.isda.org/2017/11/28/development-fallbacks-libor-key-ibors-faqs/>

impact of the transition from LIBOR to an alternative reference rate. NWG members discussed a proposed questionnaire that would serve as the basis for the corporate client outreach. Meeting participants were invited to provide feedback by 15 June 2018. The final questionnaire was published on the website of the NWG. Together with corporate associations, the L&D sub-working group will now reach out to corporates. The workshop is planned for mid-September.

5. Decisions and Recommendations

- NWG decisions:
 - Feedback on term sheet and questionnaire to be sent to nwg@snb.ch by June 15, 2018
 - Publication of term sheet for 3M SARON Futures and invitation to FMIs to start offering
 - Publication of questionnaire for corporate outreach
 - Conduct workshop with corporates based on questionnaire
- NWG recommendations to all market participants:
 - To assess the impact of different term rate approaches
 - To submit preferences regarding term rate approaches (including rationale) to nwg@snb.ch by end of July
 - To prepare for an expected transition:
 - Get transparency on current volumes, currencies and maturity profile of existing book (e.g. loans, derivatives)
 - Review / adapt new loan and deposit contracts with regard to a permanent LIBOR discontinuation
 - Engage with ISDA in order to be kept abreast of new developments as well as to offer constructive feedback
 - Get high-level understanding of technical implications and time-to-market
 - Raise awareness on senior management level

6. Next steps

- The D&C sub-working group will discuss the design for other products, notably OTC Options and Cross Currency Basis Swaps. Furthermore, the group will assess the feasibility of different term rate approaches, in particular elaborate technical details on infrastructure requirements of a derivatives based term rate. Finally, the group will liaise with other international groups regarding term rate alternatives.

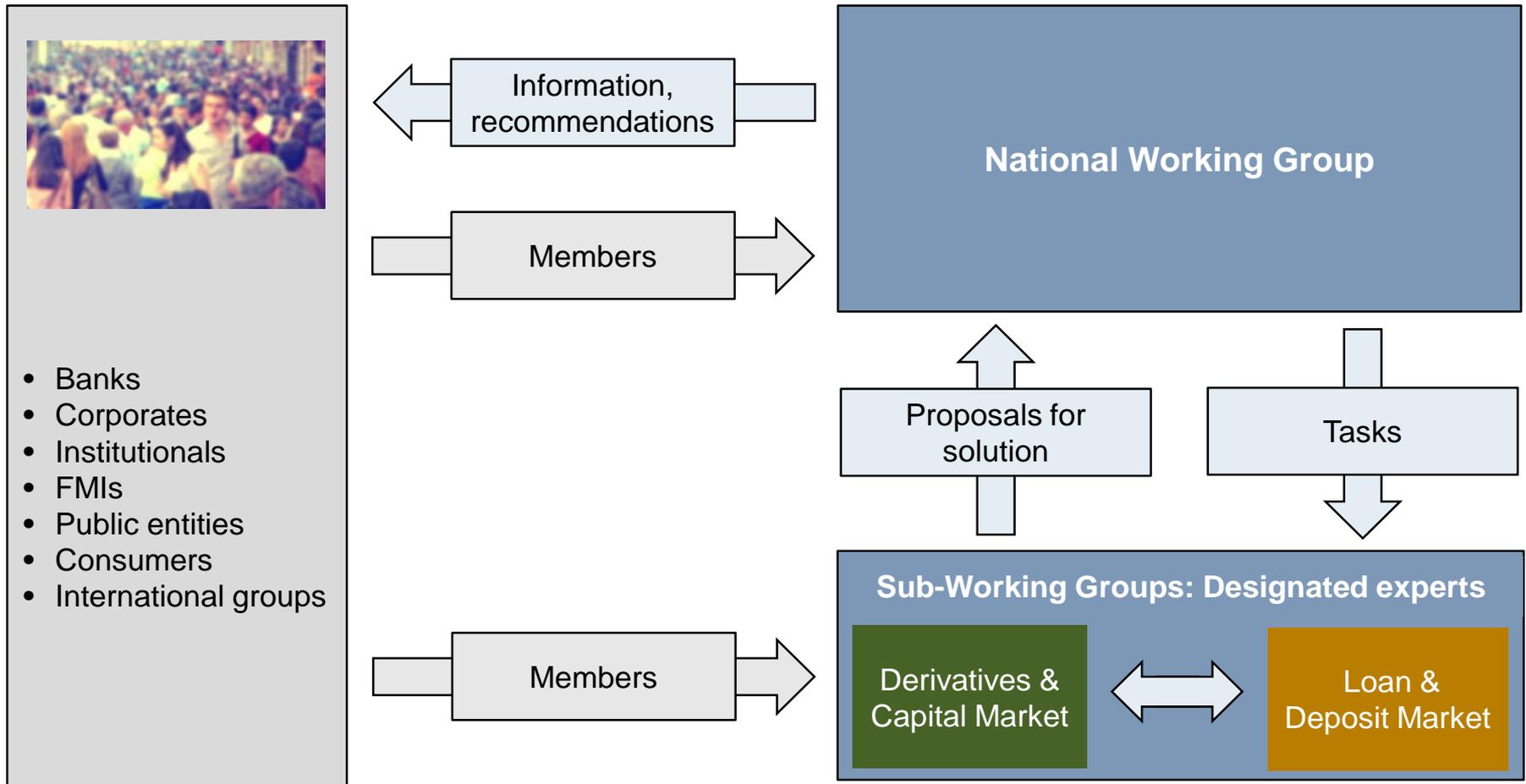
- The L&D sub-working group will review current fallback provisions and incorporate legal advice in the discussions. Furthermore, the sub-working group will conduct the corporate client outreach.
- The next NWG meeting is scheduled for Wednesday, 31 October 2018, 3:00 pm – 5:00 pm. Personal attendance is highly appreciated, but it will also be possible to dial in by phone. The following items are targeted for the meeting:
 - Recommendation on a fallback template for loan contracts
 - Conclusion on term rate based on user acceptance and feasibility
 - Educated discussion on readiness (legal and infrastructure)

Working group on CHF reference interest rates

Selected slides

19th Meeting
4 June 2018

Structure of NWG



Derivatives and Capital Market Sub-Group

Product overview

- High level prioritization plan has been agreed
- Design of SARON Futures has been agreed
- Next product to be discussed: OTC Options and CCBS

Product		Priority	Comment
Bonds	Floating Rate Notes (FRNs)	3	
Securitisation	RMBS	4	
	CMBS	4	
	ABS	4	
	CLO	4	
OTC Derivatives	IR Swaps	1	Already exists
	FRAs	2	
	IR Options	2	
	Basis Swap	1	Already exists
	X-currency swaps	3	Requires international coordination
	Constant Maturity Swaps (CMS)	5	
ETD	IR Futures	2	
	IR Options	5	
Mutual Funds	Money market funds	5	
	Bank loan funds	5	
Secured funding transactions	Repos / Reverse Repos incl. Evergreens	3	
Structured notes		3	

Pros and Cons 3M vs. 1M

	3M SARON Futures	1M SARON Futures
Pros	<ul style="list-style-type: none">▪ Methodology in-line with OIS market▪ IMM dates match the current EuroSwiss market <p>→ Expectation of higher liquidity</p>	<ul style="list-style-type: none">▪ Finer granularity to trade market expectation (in particular with respect to short end 1 to 4 months)
Cons	<ul style="list-style-type: none">▪ Less granularity	<ul style="list-style-type: none">▪ Higher operational load (e.g. more bookings)▪ Risk of less liquidity for certain delivery months

For launching the SARON Futures, market liquidity is key

The Sub-NWG D&C proposes the following recommendations:

- To promote 3M SARON Futures, but no 1M SARON Futures at this point
- To publish the term sheet for 3M SARON Futures on the website of the NWG
- To invite exchanges to follow the term sheet and provide the product

Alternatives for a «Term Rate»

Cash flow approaches

Approach	Term Rate	Forward-looking*	Fixing	Underlying market	User acceptance	Governance and infrastructure
Compounded SARON backward looking				<ul style="list-style-type: none"> Liquid and robust market exists Large and diverse number of participants Can be robustly computed for any tenor 	<p style="text-align: center;">?</p> <ul style="list-style-type: none"> User acceptance might be different across financial institutions, corporates and retail clients Ex-ante uncertainty about future cash flow Corporate outreach for further clarification 	<ul style="list-style-type: none"> No administrator required Calculation agent and publication could improve transparency
Compounded SARON forward looking (i.e. calculate rate from T-3M to T, apply for period T to T+3M)				<ul style="list-style-type: none"> Liquid and robust market exists Large and diverse number of participants Can be robustly computed for any tenor 	<p style="text-align: center;">?</p> <ul style="list-style-type: none"> User acceptance might be different across financial institutions, corporates and retail clients Payment is not lagged Hedging is complex and does not represent current market expectations Corporate outreach for further clarification 	<ul style="list-style-type: none"> No administrator required Calculation agent and publication could improve transparency

* Cash-flows are known in advance.

Alternatives for a «Term Rate»

Term rate approaches

Approach	Term Rate	Forward looking	Fixing	Underlying market	User acceptance	Governance and infrastructure
Futures-based	✓	✓	?	<p>?</p> <ul style="list-style-type: none"> No market yet Unclear whether underlying market will be liquid enough 	<ul style="list-style-type: none"> Increased complexity New basis risk may not be eliminated and makes hedging more difficult 	<ul style="list-style-type: none"> Requires an administrator (and calculation agent), which could be the exchange
Swap-based / OIS-based	✓	✓	?	<p>?</p> <ul style="list-style-type: none"> Market exists, but unclear whether underlying market liquid enough 	<ul style="list-style-type: none"> Increased complexity 	<p>?</p> <ul style="list-style-type: none"> Requires an administrator (and calculation agent) Access to information (transactions and quotes) to determine the fixing necessary
Repo-based	✓	✓	✗	<ul style="list-style-type: none"> Transparent but illiquid underlying market for some tenors Few market participants 	<ul style="list-style-type: none"> Not preferred as fixing is not daily available Collateral premium may distort rate 	<ul style="list-style-type: none"> Administrator in place

Loan and Deposit Market Sub-Group

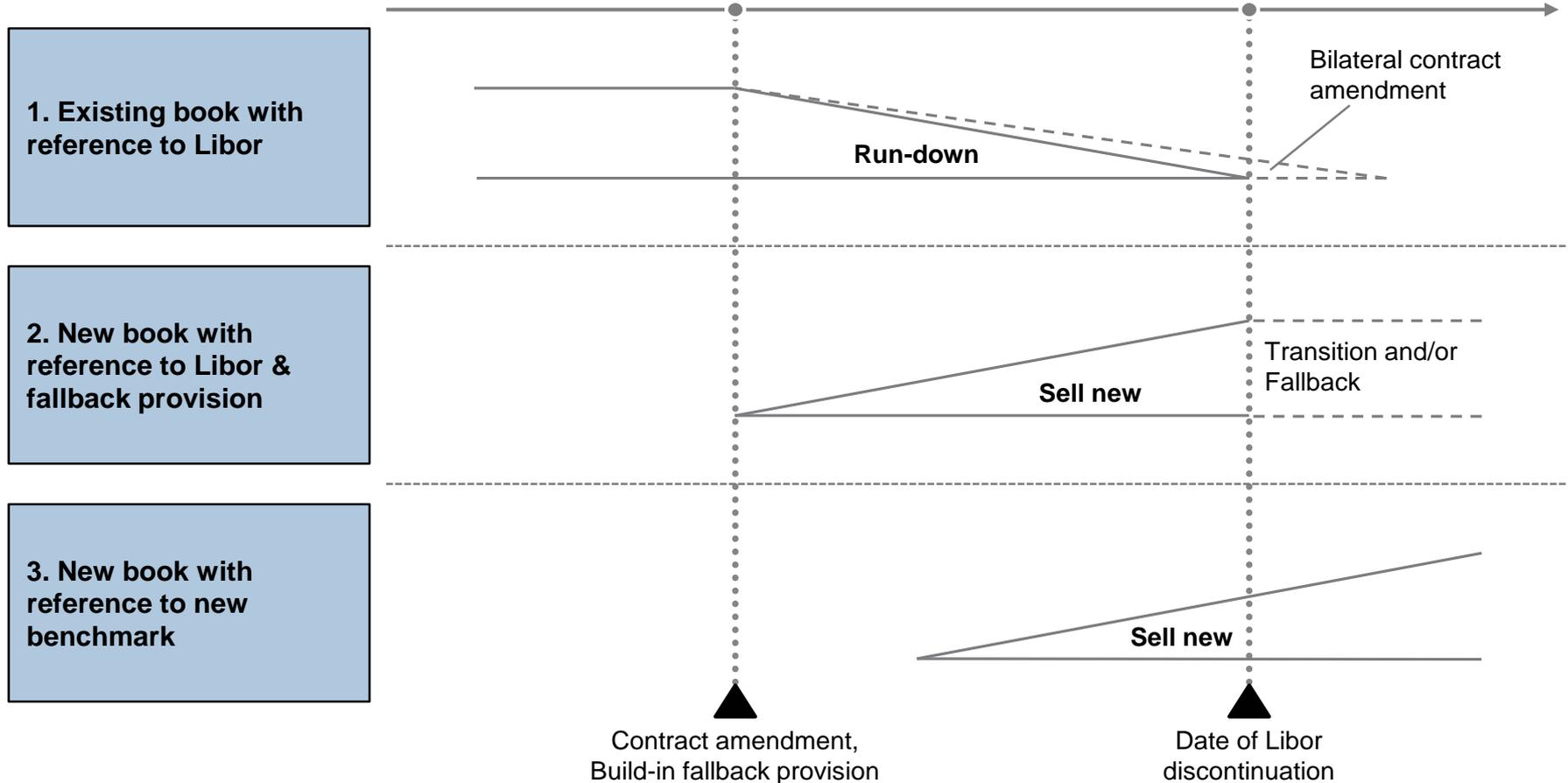
Product overview

- High level prioritization agreed
- Focus on corporate loans and mortgages given contractual maturities and volumes referencing LIBOR

Product		Priority	Comment
Loans	Syndicated loans	1	} Currently in scope
	Corporate loans (bilateral)	1	
	SME loans (domestic)	1	
	Commercial mortgages	1	
	Retail mortgages	1	
	Lombard	2	
	Credit cards	4	
	Auto loans	4	
	Consumer loans	4	
	Student loans	4	
Deposits	Retail deposits	3	
	SME deposits	2	
	Corporate deposits	2	
Other	Guarantees	3	

Product scenarios

ILLUSTRATIVE
ONLY



The Sub-NWG L&D proposes the following recommendations:

- Existing book: Get transparency on current volumes, currencies and maturity profile of book
- New book with LIBOR reference: Review / adapt contracts with regard to a permanent LIBOR discontinuation
- New book with new reference rate: Get high-level understanding of technical implications and time-to-market

Product scenarios – current focus

Existing book with reference to LIBOR

Current focus

New book with reference to LIBOR & fallback provision

New book with reference to new benchmark

- Recommend fallback template for loans
 - Coordinate with LMA / ISDA for structured / individual loan agreements
 - Define a best practice for standard loan agreements in Switzerland, incl. legal assessment
- Potential components of a fallback clause:
 - Clearly defined trigger event for fallback activation
 - Fallback rate or product alternative
 - Adjustment spread to minimize value transfer in transition

Corporate client outreach

Considerations in the client outreach

- Understand the **preferences** of corporate clients for the different approaches (“cash flow” and “term rate approaches”)
- Understand and raise awareness of the impact of the **transition** from LIBOR to a alternative reference rate
- Understand impact on **different corporate client segments** (e.g. SME, Corp., Multi)

Structure of the outreach

1. Company Profile
2. Current Usage of LIBOR Fixing (short term lending, credit facilities, capital markets, Derivatives, etc.)
3. Need of Term Fixing and usage of SARON (important characteristics of LIBOR such as official fixing, unsecured rate, reliability, forward looking, etc.)
4. Transitional issues (external factors, internal systems, time requirement, etc.)