



**Embargo**

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**The international reform process so far and the importance of  
interest rate benchmarks from a central bank perspective**

Joint Event SIX Swiss Exchange and SFAA Swiss Bond  
Commission

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Zurich, 22 September 2017

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\* The speaker would like to thank Roman Baumann, Basil Guggenheim and Peter Kuster for their valuable support in drafting this speech.



Ladies and gentlemen

Thank you very much for the kind invitation to this event (**slide 1**). Credible, robust and resilient interest rate benchmarks are a cornerstone of modern financial markets. They are also relevant for central banks and regulators. As market participants, you are all well aware of these connections. The strong reactions to the announcement by Andrew Bailey, chief executive of the Financial Conduct Authority (FCA), on the limited sustainability of the Libor, have shown how sensitive this topic is. I will take this opportunity of giving you an initial brief glimpse of the global efforts in the reform process so far as well as the challenges in the not so distant future. In the second part of my presentation, I will say a few words on the importance of interest rate benchmarks from a central bank perspective.

Let me start with a short overview (**slide 2**). As a consequence of the financial crisis, which began ten years ago, turnover in the unsecured money market, the calculation basis for the Libor, had decreased to record low levels for all currencies. This shift away from the unsecured money market also occurred in the Swiss franc, as shown in the right-hand chart. And yet Libor is still extensively used as a benchmark, as seen in the upper-left table. This applies very strongly in the case of the Swiss franc. The lower-left chart shows the importance of various reference rates in Switzerland according to our quarterly Bank Lending Survey. A total of 80% of all contracts are directly or indirectly linked to the Libor. What are the reasons for the persistent popularity of the Libor? Even if for some purposes other benchmarks would be more suitable, financial markets tend to focus on a single benchmark. This increases liquidity and lowers trading costs. Once most products refer to a single benchmark, it is hard to pull the plug and move to a viable alternative. Due to the development in the underlying market, the once credible and robust Libor benchmark is now in jeopardy. Is it possible to reform it or is a transition inevitable?

### **International reforms – is the two-rate approach still realistic?**

Turning now to international reforms I would like to pass to the centre stage of overall reform efforts with the main actor, the Financial Stability Board (FSB). To coordinate the international reform process (**slide 3**), the FSB has established the Official Sector Steering Group (OSSG), a working group with participants from official sectors around the globe, including the SNB.

In 2014, the OSSG recommended pursuing a two-rate approach. Its first recommendation was to strengthen existing unsecured rates, the so-called IBORs, such as the Libor, given their practical relevance. The second recommendation was to develop or identify almost risk-free rates. The premise of the second objective is that many users are seeking a measure of the general level of interest rates. For them, the bank credit component of the Libor is neither necessary nor appropriate. Thus, the two-rate-approach is theoretically beneficial, as for certain usages unsecured rates are appropriate and for others almost risk-free rates fit better.

For several years, intense effort was dedicated to both recommendations, which were pursued at full speed. However, today, we are confronted with a fundamental question. Is it still feasible to have two benchmarks in the long run?

I will attempt to find an answer by taking you back a number of years (**slide 4**). In the 1980s, in an environment of increasingly internationalised financial markets, banks realised they needed a consistent benchmark to calculate prices for bank-to-bank services in different currencies. British Bankers' Association (BBA) Libor fixings officially started on 10 January 1986, and the Swiss franc Libor dates back to 1989. The Libor soon became a success story, a bestseller and a longseller. Currently, contracts with a notional amount of around 300 trillion US dollars use the Libor as their reference. However, in 2012, the Libor manipulations came to light – and the success story started to lose its glory. In September 2012, one of the findings of the UK regulator's Wheatley Review was that the Libor should be retained as a benchmark. This triggered a long series of reforms. Following the recommendations of the review, the Libor became regulated and its administration was transferred from BBA to ICE Benchmark Administration (IBA).

Without any doubt, IBA has done a good job with extensive reform measures. They have included reviews of benchmark methodologies and definitions, data collection exercises and feasibility studies, consideration of transitional and legal issues, and broad consultations with submitting banks, users and other stakeholders. The governance structure of the Libor is now far more robust than it was. However, the credibility and robustness of a benchmark also depends critically on liquid underlying markets. In the case of the Libor, as I have already mentioned, these are very thin. Even for the most liquid Libor currency, the US dollar, submissions for longer tenors are based to over 50% on panel banks' expert judgements. Against this background, it is clear that the two-rate approach no longer appears realistic. Despite all the measures that have been taken, it seems impossible to re-establish the Libor as a credible, robust and resilient benchmark.

In hindsight (**slide 5**), these extensive efforts to save the Libor have not been in vain. Three important lessons can be learnt from the overall benchmark reform process. First, market consultation in order to achieve market acceptance is pivotal. IBA issued two position papers in 2014 and 2015, followed by several roundtables around the world. One of these was hosted by the SNB. In Switzerland, we did the same for our national benchmark SARON in 2016. Second, another requirement for a credible benchmark is an independent committee, which guides the administrator. In Switzerland, we have established committees of this kind for the TOIS fixing and SARON. Third, sound and overarching principles for benchmarks, as those defined by the International Organization of Securities Commissions, are essential.

Since a revival of the underlying market is unlikely, the foundation for the Libor will remain shaky. Without the support of the FCA after 2021, especially in securing sufficient participation in the panels, the survival of the Libor cannot be taken for granted. Given these bleak prospects, work on planning a transition to alternative reference rates should start now.

A shift away from such a benchmark which is so extensively used as the Libor is quite a challenge and will take some years.

That is the sobering news. The very future of the Libor is in serious jeopardy. Fortunately, however, alternative rates are available, at least for most currencies. Around the globe, various working groups have taken on the challenge of developing or identifying alternatives for specific currency areas (**slide 6**). Generally speaking, almost risk-free reference rates can serve as alternatives to the Libor. They are anchored in overnight money market transactions because the underlying market is, as experience has shown over the last years, too thin for robust tenor rates. Due to the short maturity, these alternatives – even if some of them are based on unsecured markets – can be seen as risk-free proxies.

In the US, the working group recommended a broad treasuries repo rate as an alternative this June. The rate will be introduced in the first half of 2018 and a derivative market will be established quickly thereafter.

In the UK, the working group has recommended SONIA as an alternative. The Bank of England is administrating SONIA and has announced reforms, which should be fully implemented next year. Already today, a comparable liquid derivative market for SONIA exists.

For the euro-area and the yen, the focus is less on the Libor, as Euribor and Tibor are the most widely used benchmarks. However, should doubts arise about the Euribor and the Tibor as well, the potential alternative reference rates would also be overnight rates.

In Switzerland, the key forum for reform proposals is the National Working Group on Swiss franc reference rates (NWG), which has been guiding the reform process since 2013. As we have already learnt from the invitation to this event, one obvious alternative benchmark could be SARON. With respect to the transition process we already have substantial achievements to build upon. First, SARON is not a benchmark created out of the blue. As the most prominent member of the Swiss Reference Rates (SRR), it is an established interest rate benchmark family based on transactions and executable quotes from the Swiss franc repo market. The benchmark family was launched jointly by SIX Swiss Exchange and the SNB in August 2009. This demonstrates the SNB's long-term commitment to the market in the area of benchmarks. At the beginning of 2017, SIX Swiss Exchange founded the SRR Index Commission, which will periodically review all aspects of SARON. Today, market participants are at the point of mastering a first transition to SARON, as the TOIS fixing will cease to exist at the end of 2017. Admittedly, the transition from the Libor will be a much more extensive process. Nevertheless, I am convinced that some valuable lessons can be learnt.

## **Benchmarks – why they are important for central banks as well**

I will now turn to the second part of my presentation, the importance of interest rate benchmarks for monetary policy. My starting point is again the dominance of the Swiss franc Libor in financial products (**slide 7**). It is estimated that contracts with a notional amount of approximately 6 trillion Swiss franc use the Libor as a benchmark. In addition, the Libor swap curve is widely used for price discovery in the Swiss franc capital market. It is of paramount importance for pricing new issues in the primary market and for trading bonds in the secondary market, which are sometimes relatively illiquid. Furthermore, the Libor swap curve represents the backbone for price discovery of loans in Swiss francs, including mortgages. In a nutshell, the Swiss franc Libor is by far the most important interest rate benchmark for the Swiss economy, and has been for decades.

Against this background, the SNB chose the Libor as the reference rate when adopting its new monetary policy strategy in late 1999 (**slide 8**). This strategy is still valid. At the operational level, we fix a target range for the three-month Swiss franc Libor, which is one of the three elements of our monetary policy strategy – the others being the definition of price stability and the conditional inflation forecast. Our reference interest rate, the Libor, has served us very well since 1999. This was especially the case during the financial crisis, when the target range enabled the SNB to prevent an increase in the Libor despite higher credit risks.

As regards monetary policy transmission, benchmarks, such as the Libor, capture the relevant level of short-term interest rates in a specific segment of the money market and are therefore directly impacted by central banks' interest rate decisions. Hence, benchmarks are transmitters of monetary impulses to financial markets and the broader economy. The more widely a given benchmark rate is used for pricing financial contracts, the more efficiently monetary impulses are transmitted. Furthermore, robust benchmarks increase the transparency with respect to the prevailing financial conditions.

Central banks are capable of controlling the level of short-term interest rates in a variety of ways. In particular, the policy stance is not tied to the existence of a specific reference rate. This is also the case for the SNB. Thus, a discontinuation of the Libor would neither affect our monetary policy stance nor our ability to ensure price stability.

The SNB will continue to support market participants in the interest rate benchmark reform and transition process. But in the end, market participants themselves are responsible for choosing alternative rates and ensuring a timely transition.

## **Preparing the transition – act now!**

To sum up, interest rate benchmarks are important for the private and public sectors alike (**slide 9**). The private and public sectors depend on benchmarks for price transparency and discovery. Benchmarks can be considered as rule-driven calculated average market prices and therefore improve price transparency. Furthermore, benchmarks are official fixings which are

broadly used for derivative products. Banks have a natural demand to hedge their risks. Derivative products allow market participants to trade and reduce their risks. Such products depend crucially on benchmarks. Against this background, it is in the private sector's own interest – and it is their responsibility – to keep benchmarks credible, robust and resilient. However, given the Libor's characteristic as a public good, a transition will be very demanding for the private sector. This transition will be much more challenging than the SNB's choice of a new reference rate for its monetary policy concept. The dominance of the Libor and the dependence of markets on it means that the switchover will be tricky. Nevertheless, an orderly transition to a stable solution is manageable. However, it requires a bold collective effort. The transition will be less risky and less expensive if it is well prepared, planned and executed. By contrast, a rushed and uncoordinated shift away from the Libor might prove risky and costly for all actors.

In Switzerland, the NWG is in charge of coordinating the reform process (**slide 10**). I would like to take this opportunity to thank all the people involved for their hard work since 2012. While there is still a long road ahead, we have made significant progress so far. As compared to other countries, Switzerland is well prepared for the next decisive stage of benchmark reform. The SNB will continue to guide the market closely, as it has done in the past, for instance by launching the SRR. Keeping the process transparent is another essential requirement for a smooth transition. That is why all important NWG documents can be found on the SNB website. Let me finish by repeating my key message once again. The Libor's fate is not yet sealed, but things seem to be pointing in that direction. In the light of the importance of stable benchmarks for financial markets you should definitely act now, if you have not already started planning the transition. All market participants can contribute to an orderly transition by thoroughly reviewing their current dependence on the Libor, by actively participating in the numerous sub-working groups and by constructively adhering to the guidance given by the NWG. If we meet the common challenges in this spirit, then the overall reform process will have achieved its aim.

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# The international reform process so far and the importance of interest rate benchmarks from a central bank perspective

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Joint Event SIX Swiss Exchange and SFAA Swiss Bond Commission  
Zurich, 22 September 2017

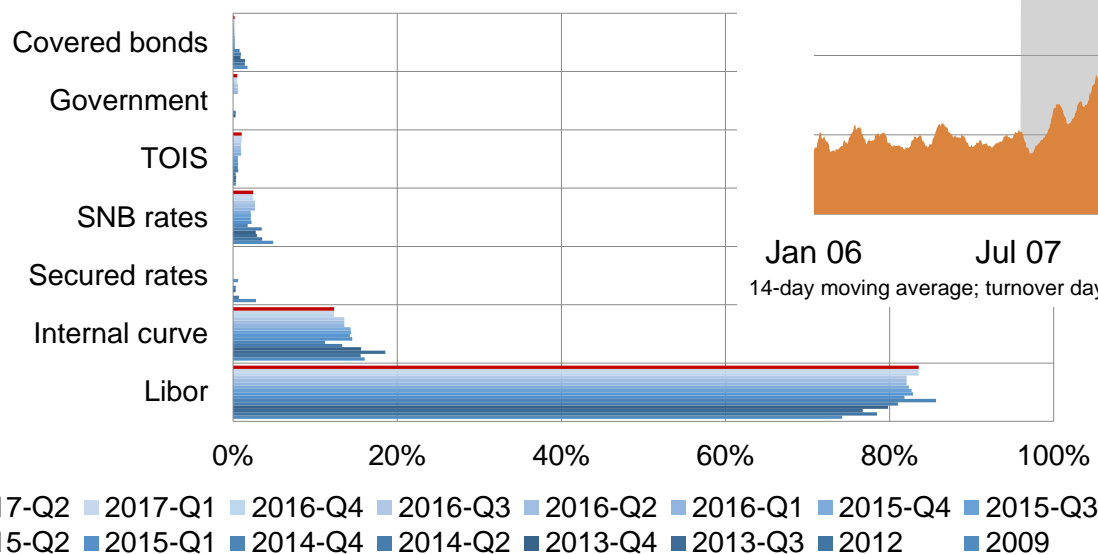
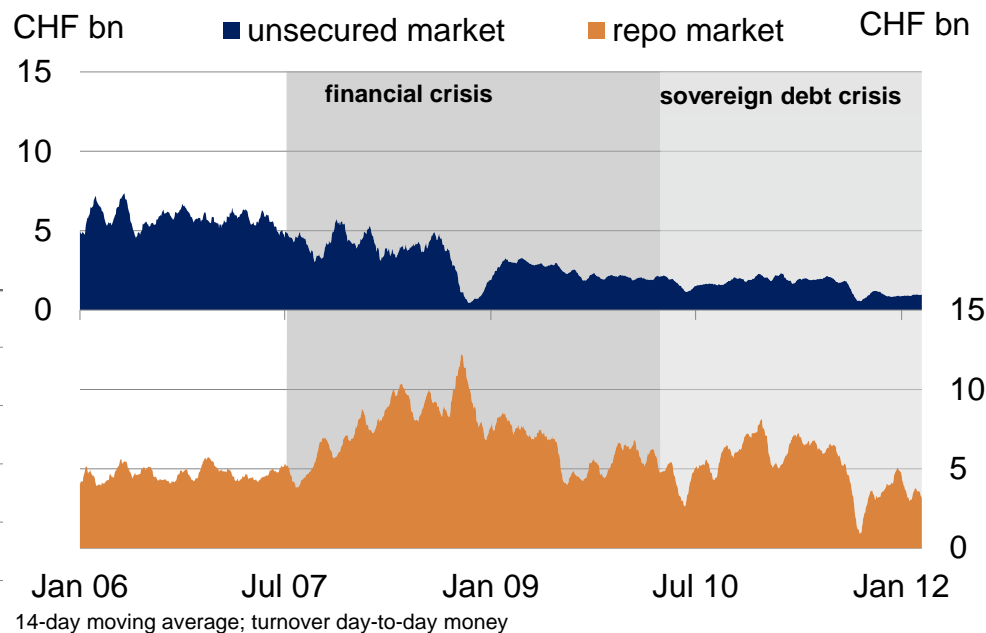
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# Overview

Reference rate estimated notional volumes and maturity concentrations

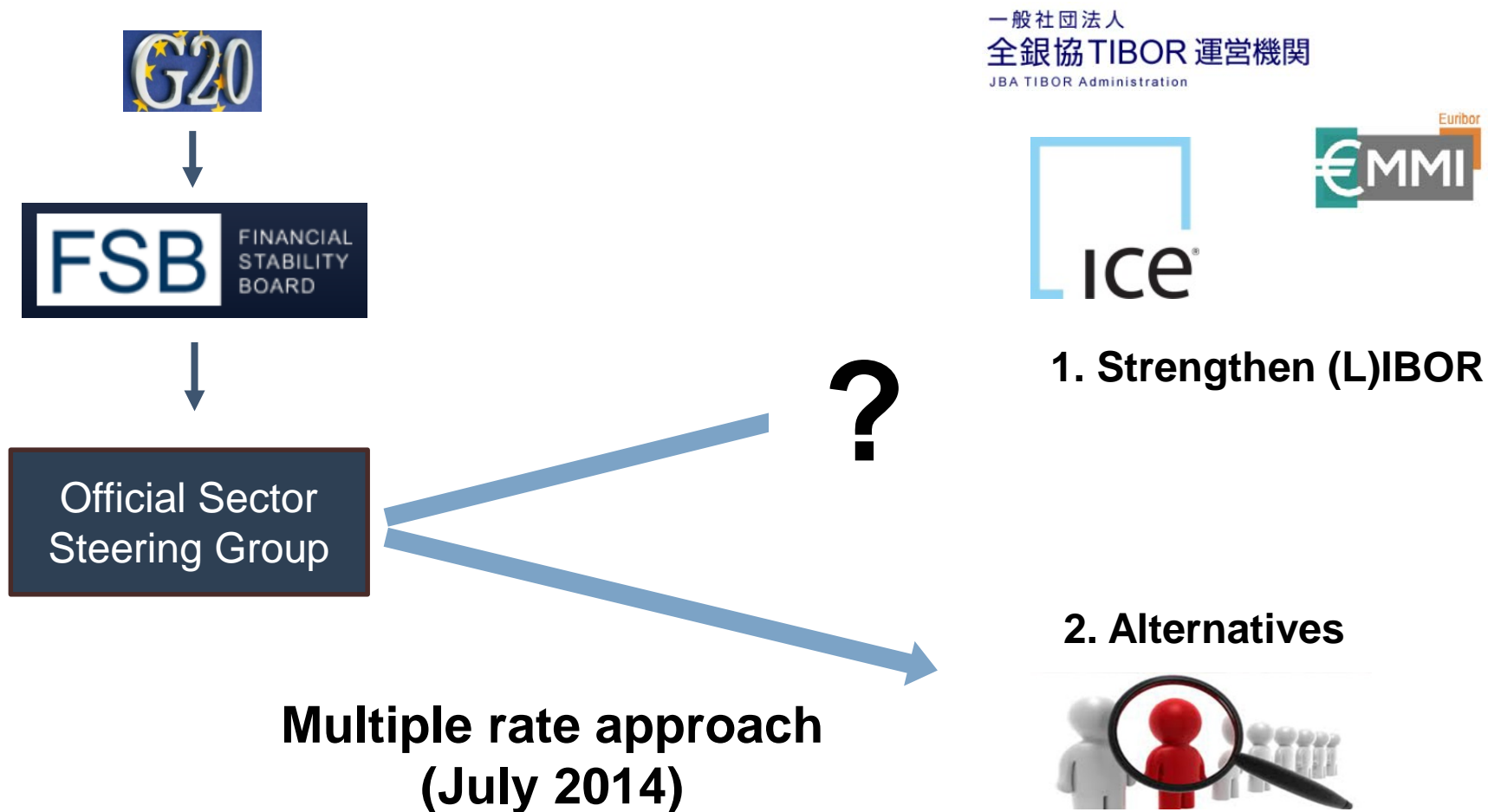
Rate	Currency Type	Notional o/s (STN) <sup>1</sup>	Main Maturity Concentration
LIBOR	USD	\$150–160 TN	1 week, 1m and 3m and 6m
	GBP	\$30 TN	3m; then 1m & 6m
	JPY	\$30 TN	3m and 6m
	CHF	\$6.5 TN	3m and 6m
	EUR	\$2 TN	Low across all tenors
EURIBOR	EUR	\$150–180 TN	1m, 3m and 6m
TIBOR	JPY	\$5 TN	6m and 3m



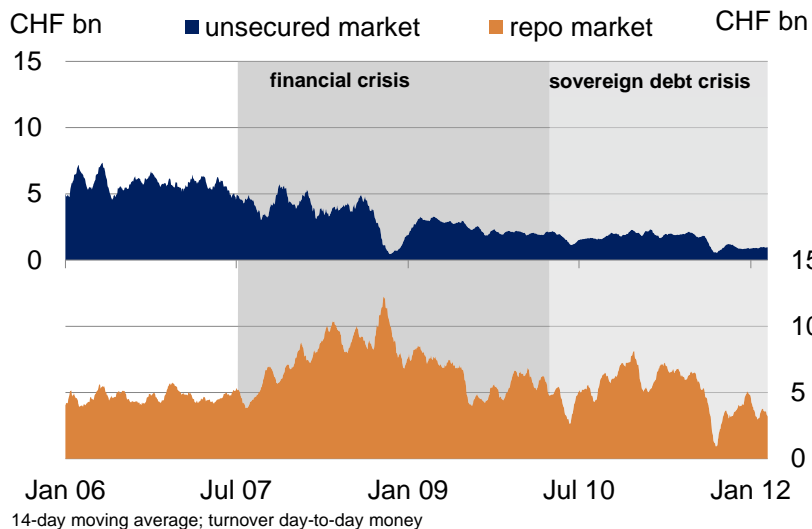
Source: SNB, FSB (Reforming major interest rate benchmarks, 2014)



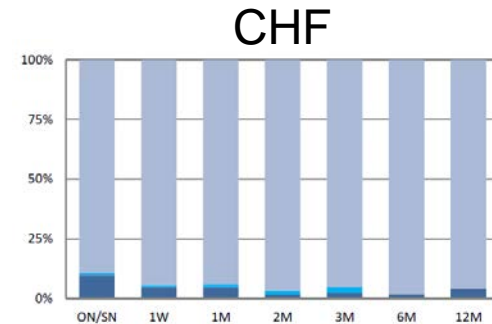
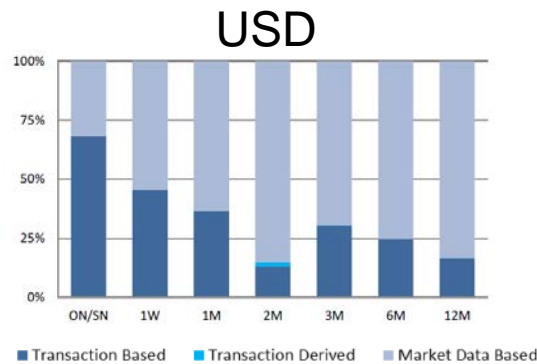
# Coordinated international response: FSB recommendation



# The long series of Libor reforms ...



... and their limits, the true problem of Libor



Source: SNB, IBA

# Milestones achieved and the likely end of Libor

Market consultation



Oversight Committee



IOSCO Principles



Three general reform milestones

Summary of Libor reforms



FCA speech



End of FCA support



Transition planning should begin now

Jan 2017

July 2017

End 2021

# Alternatives to Libor



**Broad Treasuries  
repo rate, but not  
yet finalised**



**SONIA, as the  
preferred choice**



**EONIA, or a  
another rate?**

**But focus on  
Euribor**



**TONAR**

**But focus on  
Tibor**

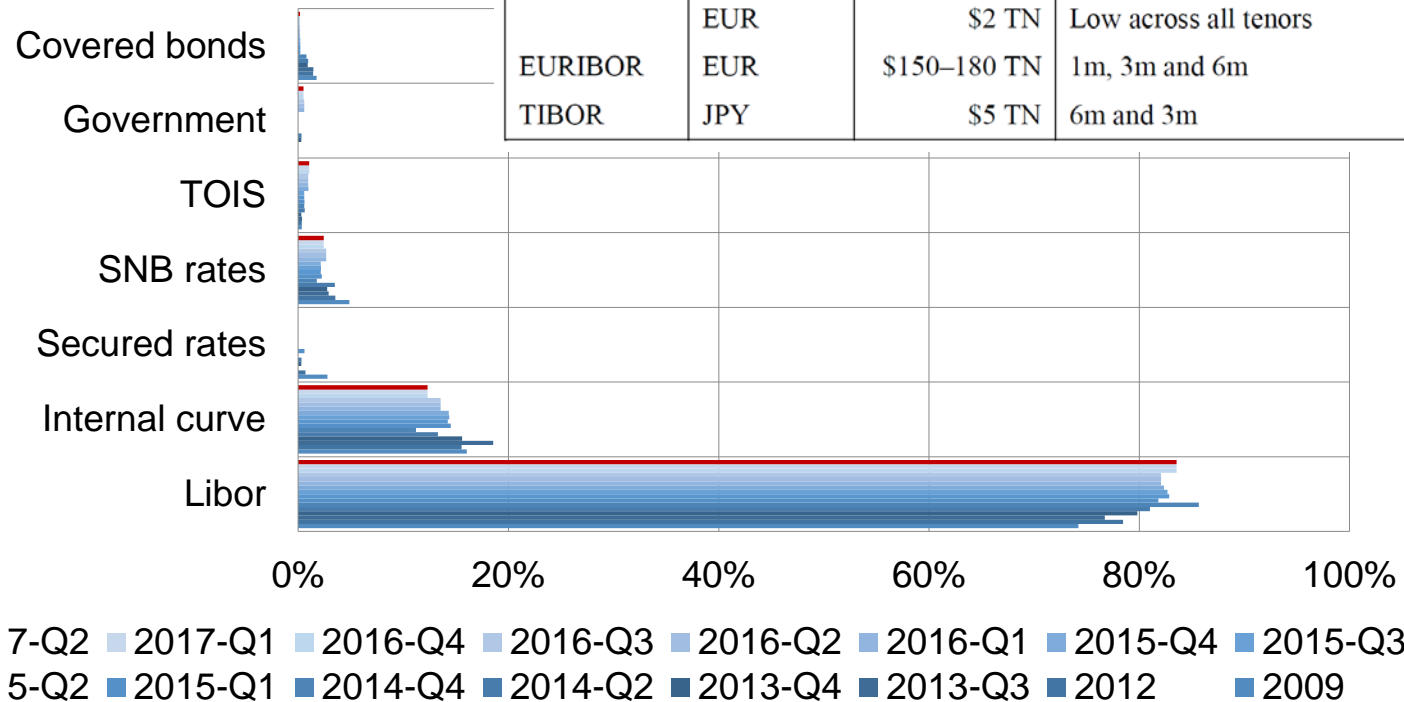


**SARON**

# Dominance of Libor in financial products

Reference rate estimated notional volumes and maturity concentrations

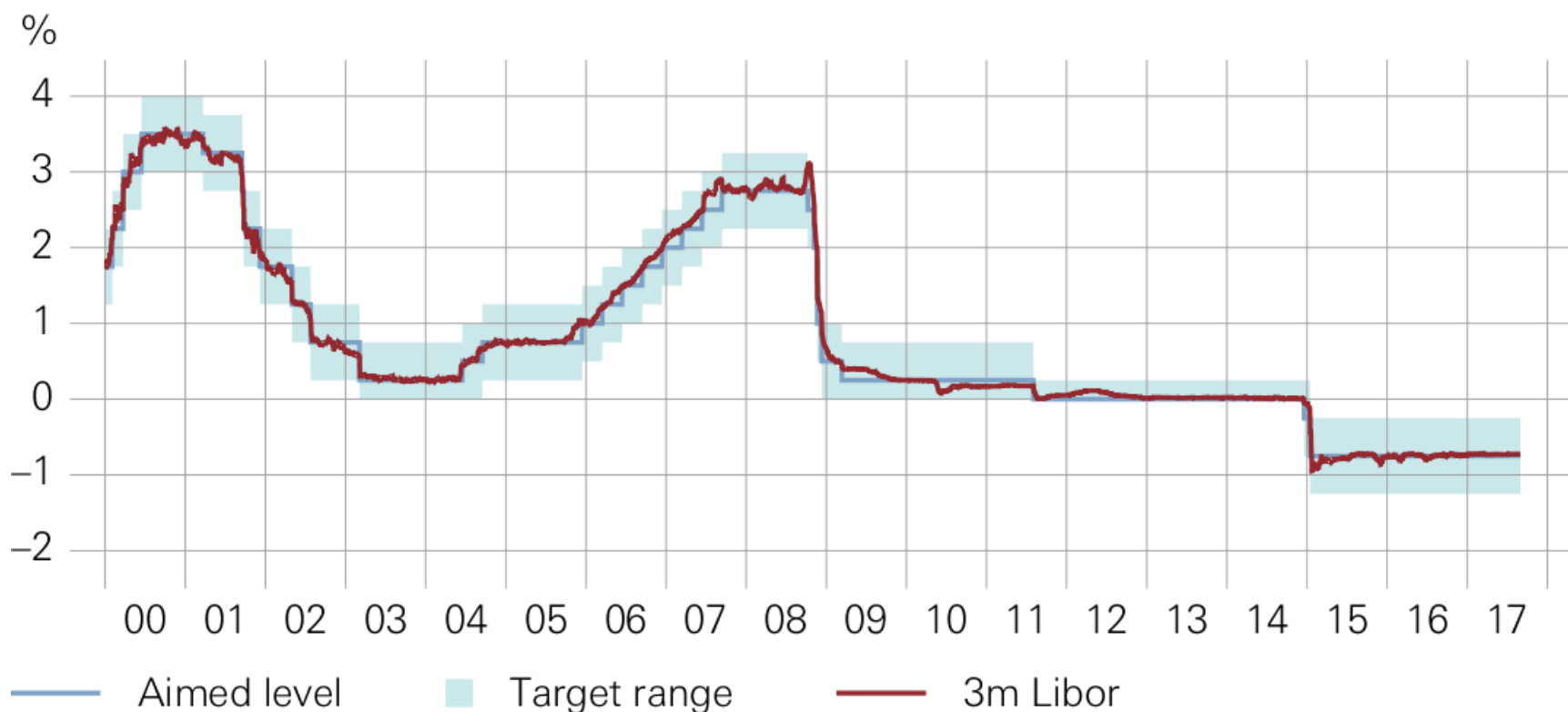
Rate	Currency Type	Notional o/s (\$TN) <sup>1</sup>	Main Maturity Concentration
LIBOR	USD	\$150–160 TN	1 week, 1m and 3m and 6m
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	CHF	\$6.5 TN	3m and 6m
	EUR	\$2 TN	Low across all tenors
EURIBOR	EUR	\$150–180 TN	1m, 3m and 6m
TIBOR	JPY	\$5 TN	6m and 3m



Source: SNB, FSB (Reforming major interest rate benchmarks, 2014)

# Swiss franc Libor as monetary policy benchmark

## TARGET RANGE FOR 3M LIBOR

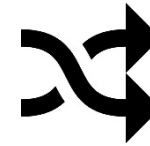


Source: SNB, Bloomberg

# Importance of benchmarks



**Price transparency  
and discovery**



**Usage in derivative products**

**→ Private sector remains responsible**

- Lock-in-effect hampers transition away from Libor
- Authorities will continue to guide market participants
- Transition planning should begin now

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# Reform of benchmark interest rates

The national working group on Swiss franc (CHF) reference rates (NWG) is the key forum for considering proposals to reform reference interest rates in Switzerland and discussing the latest international developments. The NWG was founded in 2013 and has since been guiding the reform process relating to CHF reference interest rates. The NWG is co-chaired by a representative of the private sector and a representative of the SNB. The group is open to representatives of domestic and foreign banks and specialists from other sectors of the finance industry. Banks not yet represented in the NWG are welcome to join. The Swiss Financial Market Supervisory Authority (FINMA) is invited as an observer.

## National working group governance

The SNB supports the efforts to reform benchmark interest rates being undertaken at national and international level. At national level, this includes co-chairing the NWG alongside a representative from the private sector. NWG recommendations are not legally binding. Decisions on recommendations are passed with a simple majority of the votes cast at the meetings. As market participants are responsible for providing reference interest rates, the SNB abstains from voting and acts primarily as a moderator. Furthermore, the SNB runs the NWG's technical secretariat and facilitates the organisation of the meetings. In this capacity, the SNB also provides this section on its webpage for publishing NWG minutes as well as other material on the progress of the reforms. The items published do not necessarily reflect the views of the SNB.

## FURTHER INFORMATION

10.10.2016	Summary of reform efforts until 2016	<a href="#">PDF (23 kB)</a>
10.10.2016	Minutes - 13th Meeting of the Working Group, 24 May 2016	<a href="#">PDF (31 kB)</a>
17.11.2016	Minutes - 14th Meeting of the Working Group, 27 October 2016	<a href="#">PDF (48 kB)</a>
22.02.2017	Minutes - 15th Meeting of the Working Group, 26 January 2017	<a href="#">PDF (60 kB)</a>
22.02.2017	Discontinuation of TOIS fixing and replacement with SARON	<a href="#">PDF (97 kB)</a>
22.02.2017	Draft-template for a SARON Swap confirmation	<a href="#">PDF (48 kB)</a>
08.06.2017	Minutes - 16th Meeting of the Working Group, 15 May 2017	<a href="#">PDF (41 kB)</a>



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# Thank you for your attention!

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