IBOR TRANSFORMATION
AUSTRALIAN WORKING GROUP

Meeting of the IBOR Transformation Working Group

Thursday 2 April 2020
3:00pm
Video meeting with dial-in option COVID-19 Protocol

Minutes

Attendees

Pieter Bierkens	Chair	Commonwealth Bank of Australia
Duncan Marshall	Member	Australia and New Zealand Banking Group
David Ziegler	Member	Macquarie Group Limited
Gregory Kaspar	Member	Westpac Banking Corporation
John Henson	Member	National Australia Bank Limited

Secretariat in attendance

David Love	Policy Executive	AFMA
Murray Regan	Support Executive	AFMA
Mark McCarthy	Observer	AFMA
Natalie Thompson	Observe	AFMA

1. Meeting Opening

1.1. The meeting opened at 3:04 pm. Attendees were noted as above.
1.2. The previous minutes were accepted.

2. ASIC letter in response to Group letter on Conduct Risk

After deliberation by the Council of Financial Regulators ASIC responded recently to the request for guidance and its views are set out in a letter of reply to Australian group. The letter addresses conduct risk in relation to the transition to RFRs and client communications. ASIC's guidance letter is available here.

The Group discussed in detail guidance set out in the ASIC letter. It was considered that the banks were already following the suggested approach to their customers with regard to what is fair and this meant the clients interests were to the fore with regard to understanding their intentions at the time the adjustment is agreed between the parties. The Group noted the importance of ASIC saying the "fairness" would not be judged in hindsight but at the time the parties reviewed their agreement. Therefore, subsequent developments like a COVID-19 event should not affect earlier mutually agreed decisions on fair future pricing.

3. COVID 19 and the implementation of LIBOR reform

Internationally, there has been considerable discussion in the industry about the impact of COVID-19 situation on the LIBOR transition timetable. Industry was advocating for an at least six months delay. However, in a statement made on 25 March 2020, the FCA, Bank of England and Working Group on Sterling Risk-Free Reference Rates discussed the impact of COVID-19 on the transition from LIBOR to SONIA. The current assumption is that LIBOR will still be phased out by the end of 2021 and the regulators will update the market in due course.

While the UK authorities are holding the line for now on the timetable while there is still considerable uncertainty around how long the hiatus in regulatory preparations may last, The there is room to believe that the LIBOR transition timetable may be reappraised once there is greater certainty with regard to how preparations haven affected in practice.

The Group discussed whether was a need for further discussion with Australian regulators? Given that the transition timetable is driven by UK there was little the Australian authorities could do directly to vary the timetable. However there maybe scope to discuss further down the track when there is less uncertainty about the effect of COVID-19 on market preparations.

4. Credit spread adjustments for cash products

4.1. Consultations on Credit spread adjustments for cash products

The Group noted and discussed that following ISDA's settlement on the historical median over 5 years methodology other consultations have gone ahead The Alternative Reference Rates Committee (ARRC) is seeking views on the appropriate spread adjustment methodology to be recommended as part of its fallback provision recommendations for USD cash products referencing LIBOR. The Working Group on Sterling Risk-Free Reference Rates has published a consultation paper for the sterling cash market (including loans, bonds, and securitisations) considering four methodologies that could be used to calculate the credit adjustment spread for fallbacks from GBP LIBOR to SONIA in cash products maturing beyond the end of 2021. The consultation identified a strong consensus in favour of the historical 5 year median approach as the most appropriate methodology for credit adjustment spreads in both cessation and pre-cessation fallbacks for sterling LIBOR linked cash products maturing beyond end 2021. The Group discussed the implications of these adjustments for other parts of the market.

4.2. Feedback from the latest Market Responses meeting regarding a separate consultation in Australia.

The MRWG met on 18 March and the focus of the discussion was on the topic of credit spread adjustment. The necessary characteristics for adjustment methodology were identified as:

- Eliminating or minimising value transfer at the time the fallback is applied
- Eliminating or minimising any potential for manipulation
- Transparency of calculation
- Eliminating or mitigating against the impact of market disruption at the time the fallback is applied.

The MRWG discussed the results of ISDA's consultations for the term adjustment, respondents to ISDA's various consultations favoured a 'compounded in arrears' approach to align with the applicable IBOR tenor. For the spread adjustment, a five-year median comparison calculation between the relevant 'compounded in arrears' RFR and IBOR was the preferred approach. This is applicable to BBSW / CR adjustments for OTC derivatives. The role of Bloomberg as the adjustment services vendor for IBOR fallback calculations was noted. This would give them a key role in the market since Bloomberg will calculate and publish the term and spread adjustments for the fallbacks that ISDA intends to implement for certain IBORs. The calculations will be based on the methodology developed by ISDA.

The MRWG asked AFMA to prepare a draft paper on implications of credit spread adjustment for the Australian market. This could be used as the basis for a discussion initially with other industry group on the utility likely adoption of the ISDA methodology in other parts of the market.

This WG asked about the preparation of the paper by AFMA Secretariat and were told they would be given first look at the draft.

5. Developing market practices

The Group discussed how the Shell and BAT syndicated loans seem to be setting a precedent for LIBOR syndicated lending during transition. In March, British American Tobacco Plc signed the first syndicated loan tied to the U.K.'s Sonia benchmark interest rate.

The BAT terms were discussed. The LIBOR interest rates for sterling and USD will be replaced by SONIA and SOFR respectively on the first anniversary of the signing date, or (if LIBOR cessation has not occurred) at a future date determined by BAT once the bank market is fully prepared for the transition to the alternative reference rates. Following the transition, it is anticipated that interest will be calculated by reference to screen rates specified by the parties. The terms of the facility allow the parties to elect to use the SOFR Averages or SOFR Index as published by the NY Fed and, as and when they become available, similar screen rates for compounded SONIA. The facility will also be available for drawing in euros, and euro drawings will continue to be based on Euroibor.

6. Close of Meeting

The meeting closed at 4:20 pm.