Summary of responses to the consultation report: Fallback solutions and term- and spread adjustment between Nibor and Nowa in the event of a cessation of Nibor

Number of respondents: 6 (representing 11 entities)

Respondent entities: Norske Finansielle Referanser (NoRe), Nordic Trustee, Nordea, Kommunalbanken, The Norwegian Society of Financial Analysts (NFF), SpareBank 1 (SpareBank 1 Nord-Norge, SpareBank 1 SMN, SpareBank 1 SR-Bank ASA, SpareBank 1 Østlandet, SpareBank 1 Boligkreditt, SpareBank 1 Næringskreditt).

The respondents have to a varying degree commented on the full scope of the consultation. In this summary, we have tried to summarise the feedback from those who has commented on a specific question or topic. General feedback is summarised under question 13.

Question 1: Does your institution support the recommendation from the working group stating that the fallback clause only enters into force when it is officially announced that Nibor for various reasons will cease to be published?
The respondents mainly support the working group's recommendation. One respondent emphasise that the fallback triggers must be based on objective and predefined information to ensure predictability and mitigate the risk of conflict. Another respondent underlines the importance of the fallback clause being equal across contracts so that a transition for instruments that were based on the same reference rate keeps the same relation after the transition. In relation to this situation it is referred to the fallback clause as it is defined by ISDA.

One respondent thinks the fallback clause needs to describe any potential trigger events in detail than what is stated in the consultation report. The respondent refers to the possible events as described by for instance ISDA and LMA. Furthermore, it is pointed out that the fallback clause ideally should encompass all potential events that trigger the transition to the fallback rate.

Question 2: Does your institution see the need for pre-cessation triggers?
The respondents mainly support the working group's recommendation. One respondent emphasise the need for the authorities to investigate further any potential issues that may arise related to the representativeness of the reference rate. These issues are linked to increased risk for disputes and lawsuits and possible intensive negotiations.

As under question 1, one respondent argue in the favour of pre-cessation triggers. Pre-cessation triggers would ensure that the fallback clause reflect all possible situations in line with international standards.

Question 3: Does your institution see the need for a definition of conversion date?
All respondents support the working group's recommendation. One respondent does however argue in the favour for the fallback clause to have the same format as the solution

chosen by ISDA. It is also important that this is clearly communicated to avoid the risk of a difference in interpretation.

Question 4: Should the fallback clause reflect a situation where one or more of the Nibor tenors cease to exist?

All respondents support the working group’s recommendation. One respondent state that the removal of a Nibor tenor would be defined as a “material change” according to the Nibor framework. Such an amendment shall be the case of a public consultation before a final decision is made. The consultation will give the users of Nibor the opportunity to express their view and give time to adapt. The consultation will also include any possible alternatives to the relevant Nibor tenor in question.

Question 5: Does your institution support the working group’s recommendation on a single methodology for the fallback clause?

All respondents support the working group’s recommendation. Some emphasise that it is essential to reduce the risk of conflict and possible value transfer in the event of transition from Nibor to Nowa. One respondent highlights that one common methodology will increase predictability compared to a waterfall structure that opens for different solutions depending on the situation. Another respondent refers to question 1 and the need for additional trigger events. The working group is also encouraged to discuss circular referencing to cover a situation where there has been a transition to Nowa and where an additional replacement rate has not been identified.

Question 6: Does your institution support the working group’s recommendation on the fallback clause being adapted across different markets and products?

The respondents mainly support the working group’s recommendation but there are some differences in the feedback. One respondent supports a common approach and believes that potential amendments can be made from case to case. It is not deemed necessary to adjust the fallback clause to take this into account.

Another respondent stress the importance of financial products that originally were meant to mirror each other also should do so after a transition to a fallback rate. An equal fallback clause across products and markets are considered a prerequisite for this to occur.

A third respondent underlines the point that the question of application across products and markets also relates to the different foreign exchange areas. It was also highlighted that some users of Nibor would probably prefer an international standard for some products and not a national standard for all products. The respondent encourage the working group to open up for the possibility that certain products may have another setup than what is recommended as the main rule, as long as this is related to a different international standard for the relevant product.

Question 7: Do you support the working group's proposal to use the median difference between Nibor and Nowa for calculating spread adjustment?

All respondents supported the working group’s recommendation of using the median difference between Nibor and Nowa.

Question 8: Do you support the working group's proposal to use a 5-year history for calculating spread adjustment?
All respondents support the working group's recommendation. One respondent argues that 5-year history probably is sufficient in terms of capturing the economic cycle. At the same time 5 years will still be representative of today's market.

Another respondent emphasise that the difference between Nibor and Nowa changes over time. This has to do with changes in both the risk assessment and expected interest rate development. As a basis for the calculating the spread adjustment the historical data will in theory reflect expectations of both interest rate increases and decreases.

As there is a lack of robust risk-free rates with tenor longer than one day it must however be accepted that it is not possible to perform an exact calculation of the net effect of changes in the interest rate expectations which has influenced the difference between Nibor and Nowa during the 5-year period.

Question 9: Does your institution support using estimated, reformed Nowa as the data source before 2020 for calculating the spread adjustment between the alternative benchmark interest rate and Nibor in the event of a cessation of Nibor?
All respondents support the working group's recommendation. One respondent argues that the estimated, reformed Nowa probably is a better expression for Nowa going forward compared to the historical Nowa rate. Another respondent is concerned because Nowa does not seem to capture market turbulence and liquidity issues in the same manner as Nibor. A third respondent notices that Nowa tends to closely follow Norges Bank's key policy rate and that this has been consistent since it was established in 2011. Given the close relationship the choice between the historical Nowa, the estimated, reformed Nowa or the key policy rate will not result in very different outcomes. It is however highly important that the rate used in the calculation is clearly defined and publicly available.

Question 10: Does your institution support that the replacement rate for Nibor is calculated as daily, compounded Nowa with a 2-day observation shift plus a spread adjustment?
All respondents support the working group's recommendation. One respondent state that its feedback in the previous consultation on market conventions should be addressed. The feedback was related to the need for international common standards for certain products, particularly OIS swaps. Another respondent also refers to the feedback in the previous consultation regarding potentially different views across markets.

Question 11: Does your institution support the replacement rate being converted into the same day convention as Nibor?
All respondents support the working group's recommendation. However, one respondent encourages the working group to once again discuss whether the aim to be aligned with international standards are more important than adjusting the margin for Nibor contracts to the same day convention as is the case for Nowa.

Question 12: Does your institution support the proposed fallback clause? Please suggest changes, if any.
All respondents support the working group's recommendation, although one respondent recommends that the fallback clause also includes pre-cessation events as well as circular references. Another respondent states that there might be a need to adjust the terminology and structure of the common agreements for the bonds market. A third respondent assumes that the concept "the term adjusted Nowa" which is defined as the daily compounded Nowa rate needs to be specified further.

Question 13: Are there any other matters your institution would like to comment that are not already covered in questions 1-12?
One respondent refers to the proposed fallback clause and claims that its design may not fit with the common agreements that are often used in the Norwegian corporate market. On this background the respondent questions whether it is possible to adjust the fallback language to account for this issue, and whether the working group will provide any guidance.

Another respondent stresses that its main feedback is the need for market conventions to be harmonised to the greatest extent possible across currencies and products. The respondent highly supports the working group's recommendations assuming its close link with the recommendations from for instance ISDA and ARRC.

A third respondent states that the work on alternative reference rates would probably imply a need for adjusting the common agreements for the Norwegian bonds market and changes in the production systems.

A fourth respondent asks how the recommended solution should be implemented. The respondent claims that the stakeholders should use the recommendations in an equal manner in order to achieve the greatest possible benefit. It is referred to the proposal that the EU-commission can decide on replacement rates for the most important reference rates in contracts where no fallback rate is defined. The provision will apply to institutions under supervision, but the EU-commission has stated that an equivalent decision should be made available at national level for other institutions. The respondent argues that one should address the need for a common practice when it comes to fallback for Nibor. It is also referred to the common agreements managed by Finance Norway, documentation by Nordic Trustee on bonds and the standards developed by ISDA.

A fifth respondent stresses the importance of the fallback clause being accepted and applied across products and markets. It is referred to the work on common agreements as done by the respondent above. Furthermore, the respondent is concerned about the uncertain situation regarding legacy contracts and calls for a more detailed analysis on the challenges that may arise. In particular, this applies to older contracts that are less explicit on a potential change of reference rate. The respondent points to the legal risk when amending terms in addition to costs and the uncertainty surrounding bilateral negotiations. It is referred to tough legacy contracts in England and argued that one should consider looking at ways of ensuring a smooth transition. One should also look at the possibility of addressing potential risks via new regulation.

The respondent also emphasises the importance of the fallback clause being consistent and harmonised with the terminology developed by ISDA. It is also claimed that market participants in Norway often needs to prepare the text and negotiate at a bilateral level with their counterparties on amendments in ISDA agreements. This can be time consuming and lead to a risk for not having the same fallback clause in all contracts. Including the fallback solution for Nibor in the ISDA standard documentation for derivatives will reduce risk stemming from bilateral negotiations and have a very positive impact on the work related to including the fallback clause in general.