

Working group for alternative reference rates in NOK
Meeting minutes
Friday 23 August and Wednesday 4 September 2019
Norges Bank – Bankplassen 2

Attendees:

Jørgen Gudmundsson (via telephone on 4 Sept.)	Sparebanken Vest
Ulrik Sandvig	Danske Bank
Vidar Knudsen	DNB Bank
Wenche Vatnan	Handelsbanken
Karolina Thyman	Nordea Bank ABP
Jenny Ramstedt (via telephone on 23 Aug.)	Skandinaviske Enskilda Banken AB
Dag Olav Uddu (via telephone on 4 Sept.)	Sparebankene SMN, Nord-Norge og Østlandet
Dag Hjelle (via telephone on 4 Sept.)	Sparebank 1 SR-Bank
Joakim Henriks	Swedbank
Per Erik Stokstad	Finans Norge (observer)
Kathrine Lund	Norges Bank (observer)
Marit Øwre-Johnsen	Norges Bank (observer)
Tom Bernhardsen	Norges Bank (observer)

Minutes:

At the meeting on 23 August, Norges Bank presented the results from the test reporting. The first test reporting showed an apparently more robust transaction volume in an expanded overnight rate (expanded Nowa). Such a rate will reflect the price of an unsecured overnight deposit in banks from financial undertakings. On average, the transaction volumes underlying such a rate will be substantially higher than the transaction volumes underlying the current Nowa rate. An expanded Nowa will be somewhat lower than the current Nowa. There is a tendency for the rate to fall on regulatory dates, but the impact on absolute value is smaller than on the current Nowa rate. However, transaction volumes will be higher.

In the first test reporting, it was not possible to distinguish between nationality and between different types of financial participants. In the second test reporting, banks submitted more detailed data. The new test reporting showed that the higher transaction volume in an expanded Nowa is primarily due to deposits from foreign banks, while the volume of deposits from other financial market participants is low. The analysis conducted by Norges Bank also showed that the interest rate on deposits varies widely among market participants. Generally, the interest rate on deposits from banks with an account at Norges Bank is closely linked to the policy rate. These are largely the same transactions that are used to calculate Nowa today. Deposits from foreign banks that do not have an account at Norges Bank generally have a lower interest rate. As a whole, an expanded Nowa will be closer to the current Nowa than the rate on foreign banks' overnight deposits. However the rate will vary with the size of the deposit volume from foreign banks

relative to banks with an account at Norges Bank. Norges Bank presented a chart that showed a negative correlation between the share of deposits from foreign banks and the expanded Nowa rate's deviation from the sight deposit rate.

Norges Bank also pointed out that as Norges Bank will become the administrator of Nowa as from 1 January 2020, the Bank is now drawing up a new framework for the calculation and publication of a reformed version of Nowa (reformed Nowa). A reformed Nowa will be calculated based on data already available to the central bank via banks' reporting of money market data (RPDs). This means that the current system with panel banks will be discontinued. On days where the underlying transactions are not considered to be sufficiently robust to calculate a rate, the calculation will be based on historical data rather than on estimates as in the current solution.

Before the discussion was opened, Norges Bank asked to speak. Norges Bank has an observer role in the working group and is not entitled to vote on a recommended alternative reference rate. Nevertheless, the central bank wished to put forward its view to the working group. Norges Bank is of the opinion that a reformed Nowa is the best option for an alternative reference rate. Nowa is clearly defined, it has clearly defined transaction data and a calculation method that is transparent and easy to understand. Norges Bank will start publishing a reformed version of Nowa ready for publishing from 1 January 2020.

The floor was opened for discussion. The members of the working group spent some time discussing the advantages and disadvantages of the two Nowa rates. The choice is between a reformed Nowa and an expanded Nowa as described above. The main points of the discussion are presented below.

Several of the banks were of the opinion that an expanded Nowa based on a large portion of foreign banks' deposits is problematic. It was pointed out that foreign banks' deposits cannot be traded in an active market and the pricing of these deposits has little information value. On the other hand, the expanded Nowa rate could fluctuate on a daily basis if the foreign banks' deposits increase relative to the deposit volumes traded between banks with an account at Norges Bank. This would contribute to rate volatility that is not necessarily the result of changes in liquidity conditions or other economic conditions.

The other banks again pointed to the advantage of an expanded Nowa, purely in terms of definition, in that it would be closer to the new reference rates in the euro area and the UK. The working groups in Denmark and Sweden have also recommended alternative reference rates that will more closely resemble an expanded Nowa.

Most of the banks agreed that the foreign banks' deposits were problematic. The possibility of excluding this type of deposit in an expanded Nowa was discussed. Several of the banks highlighted that even though deposit volumes from other financial market participants are currently low, they may rise in the future. An expanded Nowa could therefore be developed in pace with market changes. On the other hand, the other banks argued that it may be a challenge to identify which transactions should be included or not

included in an expanded Nowa. This could lead to inclusion decisions based on a substantial element of judgement and a calculation method lacking transparency.

Several of the banks pointed out the challenges linked to Nowa owing to the very low transaction volumes, often close to zero, at quarter-ends. As a result, an alternative calculation method has to be applied relatively often, which has undesirable consequences for a reference rate.

The working group was of the opinion that a great deal of new information had been submitted during the meeting and the attendees wished to discuss the information in their respective banks. It was agreed to hold a new meeting on 4 September, with a view to making a final decision on the recommendation for an alternative reference rate.

The discussion continued at the meeting on 4 September. The arguments advanced were largely the same. A majority of the working group's members unconditionally supported a reformed Nowa as the alternative reference rate. A minority of the members initially leaned towards an expanded Nowa. The minority argued that an expanded Nowa, defined as a deposit rate, has the potential to capture a larger number of transactions in the future, whether foreign banks' deposits are initially excluded or not. It was decisive for the minority that Norges Bank now recommends a reformed Nowa and that such a rate can be operational by year-end 2019. It is not likely that an expanded Nowa would have been operational within the same timeframe. The minority therefore supports the recommendation that a reformed Nowa be used as an alternative reference rate.

The working group aims to publish the report with the final recommendation by the end of the third quarter as previously communicated.