

Working group on alternative reference rates in Norwegian kroner (NOK)

Terms of reference

Background

Reference rates play a critical role in the global financial system. Large values are linked to these interest rates through various financial products and financial contracts. In response to revelations of attempts to manipulate global reference rates and a decline in activity in the unsecured interbank market following the financial crisis, the G20, under the auspices of the Financial Stability Board (FSB), launched an initiative to reform interest rate benchmarks. The FSB published a report in 2014 recommending a dual approach.¹ The report recommended strengthening existing interest rate benchmarks and identifying alternative nearly risk-free reference rates (RFRs). According to the FSB, RFRs will in many cases be better suited as reference rates, particularly in transactions in interest rate derivatives. RFRs should be based on a robust underlying market and comply with IOSCO's Principles for Financial Benchmarks.²

Reference rates in Norway

The most frequently used reference rate for NOK-denominated contracts is Nibor (Norwegian Interbank Offered Rate), mainly 3-month and 6-month Nibor. NOWA (Norwegian Overnight Weighted Average) is also used to some extent. These rates should reflect the interest rate level in the unsecured interbank market. Nibor is based on quotes by panel banks and are published for 1-week, 1-month, 2-month, 3-month and 6-month maturities. Nibor is constructed as an FX swap rate, ie banks apply a USD rate adjusted for the price of converting USD into NOK in the FX swap market.³ Nibor is administered by the Norske Finansielle Referanser AS (Norwegian Financial Benchmarks), which is wholly owned by Finance Norway. NOWA is based on overnight interbank loans and is administered by Finance Norway. Both rates are expected to be subject to the EU regulation on financial benchmarks.⁴

Working group on alternative reference rates in NOK

In response to the FSB's recommendations and the work in other countries in this area, Norges Bank has decided, after consultation with the financial industry, to establish a working group on alternative reference rates in NOK. The first part of the working group's work will consist of putting forward proposals on possible alternative reference rates.

¹ «Reforming Major Interest Rate Benchmarks», http://www.fsb.org/wp-content/uploads/r_140722.pdf

² «Principles for Financial Benchmarks», <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD409.pdf>

³ Panel banks can also use a deposit rate in a currency other than NOK. The forward premium then reflects the price of exchanging that currency into NOK in the FX swap market.

⁴ EU Regulation 2016/1011 sets out rules relating to financial benchmarks. The regulation is of relevance for the EEA and must be transposed into Norwegian law, see https://ec.europa.eu/info/law/benchmarks-regulation-eu-2016-1011_en.

Subsequently, the working group will work on how such a rate can be implemented as a reference rate. This mandate comprises the first phase of the work. The composition of the working group may have to be changed in a later phase.

Objectives

The main objective of the work is the adoption of one (or more) new reference rates in NOK that reflect nearly risk-free interest rates, and that can be used as alternatives to Nibor. The alternative reference rates should be anchored in transactions based on a robust underlying market.

The working group is to:

- prepare an official report with recommendations on alternatives to existing Norwegian reference rates;
- examine what type of market can serve as a basis for alternative reference rates, including whether rates exist that can be reformed or whether new rates require the establishment of new market solutions. The working group's recommendation is to include an assessment of the maturities for which there is a need for reference rates. If the working group determines that new market solutions are required, the group will propose measures;
- recommend how an alternative reference rate can be organised. The solution must satisfy the provision in EU Regulation 2016/1011 on financial benchmarks, and generally comply with the international standards for financial benchmarks. The working group will not, however, present a comprehensive proposal on a framework for the new rates;
- identify alternative contingency measures to deal with a failure of, or a substantial change in, the market basis for the underlying reference rate;
- identify the conditions that must be in place for a successful transition to the alternative reference rate. This will require, among other things, developing the necessary liquidity in contracts that refer to the chosen alternative reference rate;
- propose a plan for the establishment the new reference rate, cf indicative timetable below.

Administration and work structure

- The working group comprises representatives of Norwegian banks and foreign branches with good insight into the relevant Norwegian markets and the use of Norwegian reference rates.
- A representative of the private sector is to chair the working group. Norges Bank proposes a chair, who is then elected by the members of the working group.

- Each member of the working group represents his/her own institution.
- Each member has one vote. Norges Bank and Finance Norway will have observer status without voting rights.
- Norges Bank will undertake a secretariat function, ie prepare the meetings of the working group, draw up the agendas, publish the minutes and present the different types of analyses that have carried out by the central bank.
- Norges Bank will publish this mandate, members of the working group, agendas and minutes on Norges Bank's website.
- Non-members can be invited to make presentations or participate in some of the work of the working group. The working group can also establish sub-groups to examine more closely certain themes if deemed appropriate.
- The working group will draw on relevant operators as key counterparts and important final users to support the working group's work.

Indicative timetable

The working group should aim to publish an official report with a proposal on a preferred alternative reference rate by the end of 2019 Q1. The implementation of and transition to the alternative reference rate should be completed by end-2020.

Confidentiality

All information provided, discussions and statements during the meetings of the working group are subject to a duty of confidentiality, if the working group has not approved public disclosure of such information.