

Memo

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Summary of the Riksbank's survey on SWESTR

The Riksbank has carried out a survey among financial market participants to support a transition from STIBOR to SWESTR. The responses suggest that it is important that the Swedish market follows international developments, where more and more reference rates are being replaced by transaction-based risk-free rates. The survey responses also indicate that a transition is easiest to make for short maturities, while a transition for longer maturities involve more work for financial market participants. However, several factors play a role in the choice of reference rate. Liquidity and market standards have been highlighted as the most important factors for the participants. In addition, the answers highlight the fact that there are both technical and legal challenges associated with a successful transition. Many therefore believe it is important that all parties involved agree on a clear plan for the Swedish market as soon as possible.

The survey was aimed at potential users of SWESTR

As part of the work of supporting a transition from STIBOR to SWESTR, the Riksbank conducted a survey in November 2021. The survey was published on the Riksbank's website and was emailed to more than 100 financial market participants. The questions were directed primarily to potential users of STIBOR - both Swedish and foreign - but also to other organisations in the private and public sector that might have views on reference rates.

The survey consisted of 19 questions about how different reference rates are used and what factors play the most important role in making a transition from STIBOR to SWESTR possible. In total, 20 respondents answered at least two of the survey's questions. Half of the respondents were in the banks category and a quarter were in the financial infrastructure category. The remaining respondents were real-estate companies, pension companies, non-financial corporations and a representative of an industry organisation responding as a private individual. All responses are important for the Riksbank's work of ensuring that SWESTR contributes to a stable and efficient financial system and to the effective implementation of monetary policy.

The shortest maturity T/N is used least and is expected to be easiest to replace

For all respondents, the three-month STIBOR is, by far, the most common reference rate and maturity. Most respondents use at least one type of financial contract that refers to STIBOR and financial derivatives is the most common type of contract (the remaining types are bonds, loans and others).

In general, the responses suggest that the maturity, the volume in the market and the degree of complexity of the instrument for which the reference rate is used are the main factors affecting which contracts the market considers easiest or most difficult to switch from STIBOR to SWESTR.

Several respondents have replied that contracts referring to STIBOR T/N would be easiest to switch to contracts referring to SWESTR. This is partly because the difference between the two interest rates is small and partly because the volume of these contracts is small in relation to the volume of contracts linked to the three-month STIBOR. A small proportion of respondents have replied that interest rate swaps and other derivative contracts without optionality (linear derivatives) belong to the contracts that are easiest to move from STIBOR to SWESTR.

Furthermore, the responses indicate that a transition becomes more difficult to make with contracts with longer maturities (e.g. individual loan agreements) and, in particular, contracts linked to the three-month STIBOR. This difficulty is because the volume of contracts referencing the three-month STIBOR is the largest of all maturities and that the volume is made up of many different types of contract. Complex derivatives such as cross-currency basis swaps, basis swaps and exotic derivatives were also considered more difficult to transfer to SWESTR.

Problems are predicted if Sweden continues with STIBOR while the rest of the world uses transaction-based reference rates

The survey responses suggest that interest in SWESTR would increase if the use of overnight transaction-based reference rates were to increase in the rest of the world. One reason is that it would be costly for Swedish participants with a global presence to deviate from the rest of the world as different systems and conventions would apply in different countries. A few respondents have replied that they do not foresee any major consequences in the short term if Sweden continues with STIBOR but that, in time, the Swedish market will have to adapt to international developments.

Many respondents draw particular attention to increased basis risk in cross-currency basis swaps and the risk of a fragmented market as consequences if large parts of the rest of the world switch to transaction-based interest rates while STIBOR remains the dominant reference rate in Swedish kronor.¹ Such a situation could lead to the Swedish market becoming fragmented. Fragmentation would arise in a situation in which international participants use SWESTR while STIBOR is used by domestic Swedish participants, thus creating undesirable competition between SWESTR and STIBOR. Such

¹ Basis risk is the risk that a hedge to a transaction does not show the same price change as the transaction in the opposite direction, i.e. that the movements do not cancel each other out. Basis risk may arise if a financial contract contains different types of reference rates that are constructed in different ways.

fragmentation could then lead to a deterioration of price formation in the derivatives market.

Liquidity, market standards and demand from customers are the most important characteristics of a successful reference rate

Liquidity has generally been considered the most important factor or one of the most important factors for SWESTR to become widely used. According to respondents, the most common reasons for wanting to start using SWESTR are an ambition to comply with market standards and an aim to meet the demands of customers and/or counterparties. Not least, a broad transition to transaction-based reference rates in foreign markets would be an important driving force.

A couple of respondents answer that transaction-based interest rates are generally preferred since there is less risk of manipulation. It was also stated that one reason for starting to use SWESTR is that, as a member of the panel of banks contributing to the data used for STIBOR, they do not want to bear compliance costs associated with this. In addition, they wish to avoid the risk of being suspected of manipulating STIBOR, as the banks involved in the manipulation of LIBOR were.

Several respondents have highlighted increased knowledge of SWESTR as a factor, along with the establishment of conventions for how SWESTR is to be used in various product types. Market confidence in SWESTR has also been mentioned as a factor affecting the choice of reference rate.

Several proposed measures to strengthen the conditions for a successful transition from STIBOR T/N to SWESTR

In order to strengthen the conditions for a transition from STIBOR T/N to SWESTR, several respondents note that the responsible authorities can introduce recommended implementation times for a transition or decide to remove STIBOR at a certain time. A couple of respondents have replied that a collective decision from the market to start using SWESTR instead of STIBOR is a prerequisite for a transition. Some respondents have replied that it would be positive if the clearing houses started to discount cash flows using SWESTR. It has also been suggested that a component should be calculated to capture the historical spread between STIBOR and SWESTR (spread adjustment) and that STIBOR should be calculated as SWESTR plus this spread during a transitional period (in the same way as for the transition from EONIA to €STR).

Many have also stated that one difficulty in starting to use SWESTR is that there is no developed market for overnight indexed swap contracts (OIS market) and that such a market should therefore be created. At the same time, responses from financial infrastructures indicate that it should be relatively easy to initiate a market and clearing for OIS contracts based on SWESTR. The challenge will initially be to agree on how the one-day delay in the publication of SWESTR should be handled when it comes to valuation and whether payment lag procedures should be implemented.²

² SWESTR is published with a delay of one banking day and is made available at 11.00 Swedish time. SWESTR thus reflects the transactions made on the banking day before publication. In practice, parties entering into a contract often need to

The fact that STIBOR is forward-looking and reflects credit risk suggest its continued use

Reasons given for continuing to use STIBOR include a desire to use the reference rate that is the current market standard and that is linked to the most liquid markets. Several respondents have also pointed out that STIBOR is forward-looking and leads to more predictability in future cash flows. Some respondents have replied that the fact that STIBOR also aims to reflect credit risk means that STIBOR is more accurate for current market conditions than a transaction-based reference rate like SWESTR.

Most respondents have stated that it is a disadvantage that average interest rates for SWESTR are backward-looking (unlike STIBOR, which is forward-looking), as payment flows cannot be seen until the end of the period. Several respondents have stated that both forward and backward-looking interest rates perform a function, but that forward-looking interest rates are preferable.

The majority of respondents have replied that the fact that SWESTR is a *borrowing rate*, while STIBOR is a *lending rate* has little or no significance for their operations. Instead, respondents expect that any differences between the borrowing and lending rates will be handled through a spread adjustment in contracts referring to the reference rate. Many have also noted that it is in line with international practice for transaction-based interest rates to use a borrowing rate in their calculation.

Some difficulties with IT systems and the renegotiation of contracts are expected when reference rate is changed

Most respondents in the banks category have stated that it would not pose any problems to start using SWESTR instead of STIBOR T/N in the derivatives market. On the other hand, it may take longer in those credit markets where lending rates are directly linked to STIBOR, as renegotiation of loans can take time. However, several respondents very seldom or never use STIBOR T/N and thus have no opinion on possible difficulties.

The challenge of changing the reference rate is described as partly operational in the sense that existing IT systems may need to be developed and agreements changed, but also as partly educational as some banks have responded that it may be difficult to justify the price to customers. In general, the answers suggest that the legal work is expected to be more extensive than the technical work.

allow a number of days to pass for calculations and payments of accumulated interest. This can be achieved by introducing a payment lag so that the date for the payment of interest falls a few days after the end of each interest reference period.