



# Decision

DATE: 17 November 2020  
DEPARTMENT: Markets Department  
DOCUMENT: RB PUBLIC

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Reg.no. 2020-00988

## Design of the Riksbank's new reference rate

### Decision by the Executive Board

The Executive Board decides to establish that the design and calculation of the Riksbank's new transaction-based reference rate shall be as described in the Appendix.

### The matter at hand

On 12 December 2019, the Executive Board of the Riksbank decided that the Riksbank will provide a new transaction-based reference rate for the very shortest maturity (overnight or O/N) in Swedish kronor.

With its new reference rate, the Riksbank will provide a transaction-based reference rate that can be used as a reference value for the very shortest maturity in Swedish kronor and that, in the longer term, can replace the current shortest reference rate, STIBOR Tomorrow-Next (T/N). This step is in line with international developments, in which several central banks have taken responsibility for providing transaction-based reference rates. Several of these new reference rates are already in use and on the way to replacing traditional interbank rates (IBORs<sup>1</sup>).

Reference rates are used as a common benchmark or base value in the pricing of financial contracts such as loan derivatives, FX derivatives and debt securities. Reference rates are also used in the pricing of variable-rate loans, which in Sweden is primarily loans to companies. Traditionally, so-called IBORs have been used as reference values for these purposes. IBORs that are calculated in various different ways reflect the interest rates banks demand from one another for short-term uncollateralised loans, which is to say the cost of borrowing money from another panel bank. Usually, the calculation of IBORs has been partly based on banks' bids or assessments of a reasonable interest rate for unsecured loans for the maturity in question under

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<sup>1</sup> One common designation for these interbank rates is Interbank Offered Rate. For example, LIBOR stands for London Interbank Offered Rate, while STIBOR is the Stockholm Interbank Offered Rate. This has given rise to the acronym IBOR.

prevailing market conditions. These interest rates are thus not directly based on actual transactions, but are based on a certain measure of expert judgement.

During the global financial crisis of 2008-2009, liquidity in the interbank loan market deteriorated significantly. This contributed to uncertainty concerning whether IBORs really reflected prevailing market conditions. When reference rates are based on reported offers and leave scope for expert judgement, there exists a risk of manipulation. During the LIBOR scandal, it was revealed that several international banks had manipulated the LIBOR reference rate for their own benefit or for the benefit of individual employees.

These factors led to decreased global confidence in IBORs. Extensive reform work was therefore initiated with the aim of strengthening the reliability of and confidence in reference rates. The International Organization of Securities Commissions (IOSCO) issued a report in 2013 that contained 19 principles for reference values (“the IOSCO principles”). The same year, the Financial Stability Board (FSB) was tasked with reviewing the reference rates. The FSB made two main recommendations. Firstly, it considered that IBORs needed to be reformed. Secondly, it advocated the development of alternative reference rates based on actual transactions as a complement to IBORs.

In light of the international reform work currently under way to develop transaction-based reference rates, the Riksbank, like a number of other central banks, has taken on the task of issuing a transaction-based reference rate for its own currency. This decision was taken on 12 December 2019, following a consultation with positive support for the proposal. On 7 October 2020, a proposal concerning the definition and calculation method of the Riksbank’s new reference rate was sent for consultation, with the final date of 21 October 2020. A total of 15 responses was received. The referral bodies expressed general support for the Riksbank’s proposed reference rate, but also suggested a number of changes to the design of the reference rate, which are described in more detail in the annex. These comments have been taken into account in the design of the Riksbank’s new reference rate, in accordance with the considerations described below.

In accordance with international practice, the EU Benchmarking Regulation and the IOSCO principles, the reference rate provided by the Riksbank will be subjected to regular evaluation and may therefore be changed in the future. Such evaluations cover not only assessments of the size or liquidity of the market on which the reference rate is based, but also whether the current calculation method satisfactorily reflects the interest rate on the underlying market (that is, the overnight market in SEK). They also involve the continual oversight and assessment of the robustness requirements and their capacity to safeguard both robustness and representation regarding the interest rate and to prevent the manipulation of the interest rate.

## Considerations

It is important that the design of the new reference rate complies with international requirements and guidelines for transaction-based reference rates, that it does not deviate too far from international practice, and that it is well-suited to the Swedish

market.<sup>2</sup> Adjustments to the proposal for consultation in light of the referral bodies' views are reported in the annex. Justifications for why the Riksbank, in some respects, has not considered it possible to accommodate the views of the referral bodies are also included here.

A total of 15 referral bodies sent consultation responses to the Riksbank. All of these bodies stated that they were positive to the Riksbank administering a reference rate, and a majority also expressed support to the reference rate being based on unsecured loans in Swedish kronor for the shortest maturity, O/N. However, the referral bodies also advocated a number of changes to the Riksbank's proposed definition, in particular with regard to the transactions included in the dataset, and calculation method.

It is important that the Riksbank's new reference rate is firmly anchored among the market participants who will ultimately use the new reference rate, which is part of the reason that adjustments have been made to the proposal that is now put before the Executive Board of the Riksbank for a decision. It is also important that the definition for the Riksbank's new reference rate meets the appropriate IOSCO principles, which together with the EU Benchmarking Regulation state the principles and regulations for new reference rates.

The Riksbank considers, in line with the IOSCO principles and the Benchmark Regulation, that the reference rate shall represent the rate on an underlying market, which shall be a liquid and competitive market. The Swedish overnight market in SEK fits this description. The reference rate shall be calculated on the basis of transactions that are representative of the underlying market. To meet these criteria, consideration needs to be given to local market conditions, which in itself is also supported by the IOSCO principles. This means that the definitions or calculation methods used by other central banks are not necessarily applicable to the Swedish market.

The aim is to find a method that takes into account the specific properties of the Swedish overnight market, without deviating too far from international practice. The method shall attain the overall objective of supplying a credible reference rate based on actual transactions and fulfilling the IOSCO principles.

One important aspect that must be taken into consideration is the size and composition of the Swedish overnight market. The Swedish overnight market has several properties that distinguish it from, for instance the markets in euros, dollars or pounds sterling. Compared with these, the Swedish overnight market is small and concentrated on a limited number of participants.

One area where the referral bodies proposed changes was the transactions included in the dataset for the reference rate. The majority of the referral bodies advocated that non-financial corporations should not be included in the transaction dataset. However, the consequences of excluding transactions with non-financial corporations from the transaction dataset for calculating the reference rate would be substantial. Transactions with non-financial corporations comprise a significant, and also growing, share of the total transaction volume, and without these transactions there is a risk that the dataset

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<sup>2</sup> International practice refers to how the international guidelines are put into practice in different jurisdictions, taking local conditions into account.

would not be sufficiently robust. Due to the composition of the Swedish overnight market, this kind of reference rate would not be representative. A more detailed review of the Riksbank's opinion on this issue is contained in the annex.

Details regarding the fixing process the Riksbank proposed in the consultation will be determined more precisely during the test period, in collaboration with the reporters.

### **Proposal**

In light of these considerations, and taking into account the arguments put forward by several referral bodies, it is proposed that the Executive Board of the Riksbank decide on the definition and calculation methods pursuant to the design proposed in the annex. Briefly, the proposals are motivated by the following:

- To ensure a robust transaction dataset based on a liquid and competitive market, it is proposed that the transactions included in the dataset be retained unchanged in relation to the consultation submitted, which means that transactions with non-financial corporations will be included in the calculation of the new reference rate.
- To ensure that the normal calculation method is in line with international practice, it is proposed that it should be simplified and the sticky weights be removed.
- To avoid needing to use an alternative calculation method too often and thereby questioning the credibility of the rate, it is proposed that the robustness requirement is made somewhat more flexible.
- To ensure that the calculated reference rate becomes less predictable and that the method shall give greater consideration to transactions in the near term, and thereby reduce the risk of manipulation, it is proposed that the alternative calculation method be made somewhat less retrospective.

It is proposed that the Executive Board makes a decision in line with the above proposal for a decision. The annex describes in more detail the reasoning behind the proposal for a decision.