The Bank of England's Discussion Paper on Collateral Referencing LIBOR

8 July 2019

The Bank of England ("**BoE**") has initiated a review of its own exposure to LIBOR, and in particular, the exposure to the collateral that banks and other financial firms are asked to provide when borrowing from the BoE under the Sterling Monetary Framework ("**SMF**"),[1] where the BoE only lends against collateral of sufficient quality and quantity,[2] in order to protect itself from counterparty credit risk.

The BoE has just published a discussion paper[3] (the "**Paper**") on the approach to collateral referencing LIBOR, for use in the SMF.

The Paper advises regulated firms that:

- Newly issued sterling collateral should reference an alternative risk-free rate ("**ARFR**") rather than LIBOR.
- Where firms have existing LIBOR-linked sterling collateral that matures beyond 2021, they should seek – wherever possible – to have it re-referenced to an ARFR.
- At a minimum, the BoE expects LIBOR-linked collateral to include adequate fall-back language specifying an alternative rate in the event LIBOR ceases to exist.

The Paper advises that the BoE is currently considering the following risk management approaches for collateral linked to interbank offered rates:

1. **Option A**: The BoE may announce, at some future point, that all collateral that references LIBOR and matures beyond 2021 would become ineligible, *regardless* of its

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1 The SMF, amongst other things, provides liquidity insurance to banks and certain other financial firms during periods of firm-specific or market stress.

2 https://www.bankofengland.co.uk/markets/eligible-collateral.

3 https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/the-boes-risk-management-approach-to-collateral-referencing-libor-for-use-in-the-smf.pdf?la=en&hash=065CBDB655B4FD15ED4C1E7FDB8289BB940D6E6A.

issue/origination date (unless mitigated by adequate market solutions such as fallback language).

2. **Option B**: Alternatively, the BoE may make ineligible all collateral that references LIBOR and matures beyond 2021 that was issued/originated *after* a certain date (unless mitigated by adequate market solutions such as fallback language).

3. **Option C**: Another alternative possibility would be for the BoE to apply additional haircuts and/or a haircut that increases over time, to all collateral that references LIBOR and matures beyond 2021.

Comments to the Paper should reach the BoE by 27 September 2019. Participants in the SMF who wish to maintain the strongest possible level of borrowing capacity at the SMF should participate in the feedback process.

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