Credit adjustment spread methodologies

Consultation response

Summary

- This consultation from the Bank of England's Risk-Free Rate Working Group focuses on credit adjustment spread methodologies for fallbacks in cash products referencing GBP LIBOR.

- This is a joint response from the National Housing Federation, the Scottish Federation of Housing Associations and Community Housing Cymru.

- The International Swaps and Derivatives Association's (ISDA) historical median approach is the preferred methodology of the National Housing Federation, Community Housing Cymru and the Scottish Federation of Housing Associations.

- No other methodology should be considered for the credit adjustment spread as all other methodologies would remove the ability of our members to hedge and thereby de-risk their loan portfolios.

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Introduction

The National Housing Federation, Community Housing Cymru and the Scottish Federation of Housing Associations are the collective voice of housing associations in England, Wales and Scotland. Our joint vision is that every person can live in a good quality home they can afford.

Our members provide more than two and a half million homes for more than six million people and each year they invest in a diverse range of neighbourhood projects that help create strong, vibrant communities.

They also built more than 50,000 new homes last year, around one quarter of the total number of new homes in England, Wales and Scotland. They continue to invest in nearly 500,000 supported housing properties, including providing schemes for some of the most vulnerable in our society, such as homeless hostels and domestic abuse shelters.

Responses to questions

1. **Please indicate whether the ISDA historical median approach is your preferred credit adjustment spread methodology for cash products in respect of:**

   (a) fallbacks which apply on cessation of GBP LIBOR; and
   (b) pre-cessation fallbacks for GBP LIBOR that trigger as a consequence of a regulatory announcement of non-representativeness.

   If not, please rank the approaches in Section 5 (Description of credit adjustment spread methodologies) in order of preference (with 1 as your preferred approach).

The ISDA historical median approach, for the reason stated above, is our preferred methodology for fallbacks that apply at cessation or pre-cessation of LIBOR.

In addition, the simplicity and robustness are a significant consideration for our members. The simplicity will lead to greater understanding from our many stakeholders and there will be less concern about manipulation due to the robustness of the historical median approach.

2. **Are there any other methodologies for calculation of a credit adjustment spread which should be considered in the cash markets? If so, please indicate which of the situations outlined in (a) and (b) in Question 1**

above this methodology would be most applicable to.

No other methodologies should be considered for the reasons already stated.

3. **Please comment on the characteristics of the proposed methodologies that most influenced your decision (including whether alignment with related hedging formed a part of your decision-making process).**

Many of our members hedge their variable rate loans with interest rate swaps. In addition, others may consider this option in future. This risk mitigation tool is instrumental in robustly managing housing associations' treasury exposures and reduces the negative potential consequence on more than six million people, many of them vulnerable.

4. **Please indicate whether your comments apply to all cash products, or whether there are different considerations for different cash products.**

Our comments apply to all cash products that housing associations manage.

5. **In respect of fallbacks, would it be problematic to have different credit adjustment spreads apply based on when fallbacks take effect (i.e. prior to cessation or upon cessation of GBP LIBOR)?**

It would be problematic to have different credit adjustment spreads dependent on when fallbacks take effect, as this would lead to perceptions of loss by some organisations. To avoid this, it would be beneficial to consider applying the same 5-year lookback on the occurrence of the first pre-cessation event.

6. **In respect of fallbacks, should the credit adjustment spread following a pre-cessation fallback trigger subsequently change should GBP LIBOR be discontinued to the credit adjustment spread calculated following the permanent cessation of GBP LIBOR? Alternatively should it remain at the credit adjustment spread for the pre-cessation event?**

As stated in our response to question 5, and to avoid subsequent changes to the credit adjustment spread, the credit adjustment spread should be generated at the pre-cessation event. As, in our view, the credit adjustment spread should be based upon the historical median approach, any future changes to LIBOR would not impact on the credit adjustment spread.

7. **Please comment on anticipated operational challenges and elaborate on how long you feel it would take to overcome such challenges.**

The most significant operational challenge for our members relates to the central publication of a compounded in arrears rate calculator. If the Bank of England or the Financial Conduct Authority were to publish such a calculator, housing association board members and executive teams would have a far greater level of assurance over individual banks' calculation of this figure.

8. **Would it be problematic for market participants to use different approaches to calculate credit adjustment spreads in fallbacks or for transitioning legacy documentation across different currencies? Please explain why or why not, commenting specifically on the potential implications of using different approaches across different currencies.**

Housing associations have limited to non-existent foreign currency exposure within their organisations and this consideration is therefore not relevant to our members.

Conclusion

In our response we have set out that the ISDA historical median approach is our favoured methodology for calculating the credit adjustment spread and that no other methodology should be considered.