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# 10th Meeting of the Working Group on Alternative Reference Rates in Mexico (GTTR) December 6th, 2023



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# Topics

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# Introduction



On October 30th, the sixth session of the GTTR derivatives subgroup was held. The main topic of that session was the conversion of swap contracts linked to TIIE 28, to Funding TIIE OIS contracts in clearing houses, as well as the mismatch (basis) that some market participants will face once the conversion takes place.<sup>1/</sup>



At the end of the meeting, a consultation was held to determine the potential impacts of the problem and to analyze its possible solutions.



Thus, the first objective of this session is to review the results of the consultation and to propose solutions.



The second objective of the meeting is to state the fundamental elements of the Funding TIIE First initiative, with the aim of promoting the use of the Funding TIIE rate in different markets.

<sup>1/</sup> If a market participant has a bilateral IRS contract linked to TIIE 28 that is not settled through a clearing house, and the risk of such transaction is hedged with another contract that is settled through a clearing house, then a basis will be created with the conversion of swap contracts.

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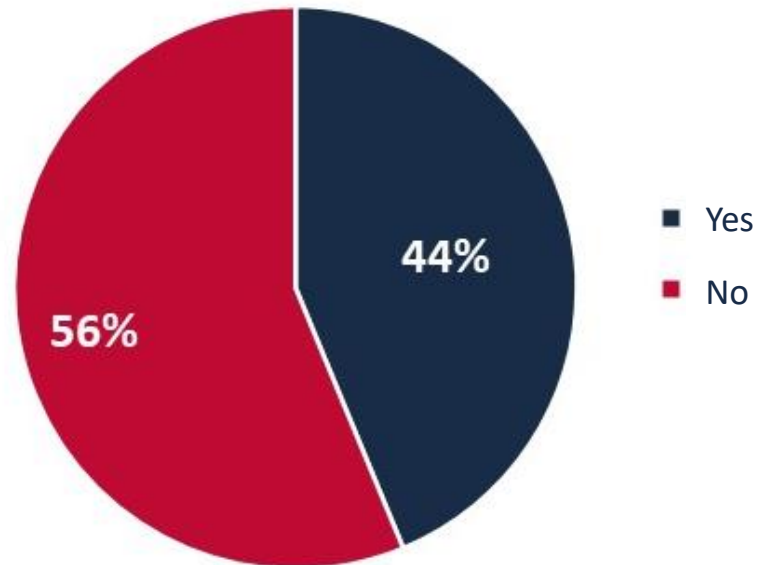
## Results of the consultation: Impact of the basis



In the consultation on the impact of the basis, 56% of the institutions that participated (16) mentioned that they would not be affected by the basis, while 44% mentioned that they would be affected.<sup>1/</sup>


### Is your institution affected by the impact of the basis?

Percentage



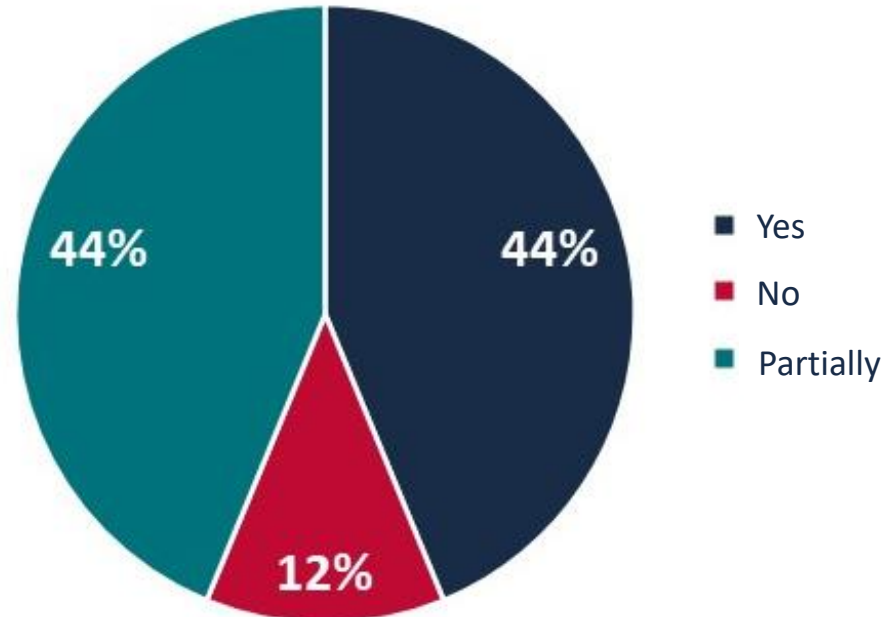
<sup>1/</sup> The percentages consider the 16 institutions that responded the consultation, 13 of them sent their comments through the ABM, 2 through the AMIB and 1 directly.

## Consultation: Treatment of the basis

 Only 12% of the institutions that participated (2) indicated that the impact of the basis is not manageable for their balance sheet, while 88% mentioned that it is manageable or partially manageable.<sup>1/</sup>

### Is the impact of the basis on your institution's balance sheet manageable?

Percentage



<sup>1/</sup> The percentages consider the 16 institutions that responded the consultation, 13 of them sent their comments through the ABM, 2 through the AMIB and 1 directly.

## Consultation: Actions by authorities



Based on the consultation, the institutions surveyed believe that the authorities could take the following actions to reduce the impact of the basis:

|   |   |
|---|---|
| <b>Support the development of a basis market</b>  | The institutions request the support of the authorities to develop a basis swaps market (floating rate for floating rate), where the existence of purchase and sale positions is guaranteed.  |
| <b>Modify the rules for the conversion</b>        | <ul style="list-style-type: none"><li>- Some participants suggest not to migrate legacy hedge transactions, cleared in clearing houses, to Funding TIIE, in order to avoid mismatching.</li><li>- Another group of participants comments that, given that the maturities of most of the current derivatives will occur in the next two years, it would be advisable to delay the conversion and/or carry it out gradually.</li><li>- Some institutions suggest that in the conversion swaps linked to TIIE 28d can be maintained for some months after December 2024.</li></ul> |
| <b>Volatility of the Funding TIIE calculation</b> | Some of the institutions requested to review the methodology with which the Funding TIIE is calculated, in order to smooth its movements and reduce its volatility.   |

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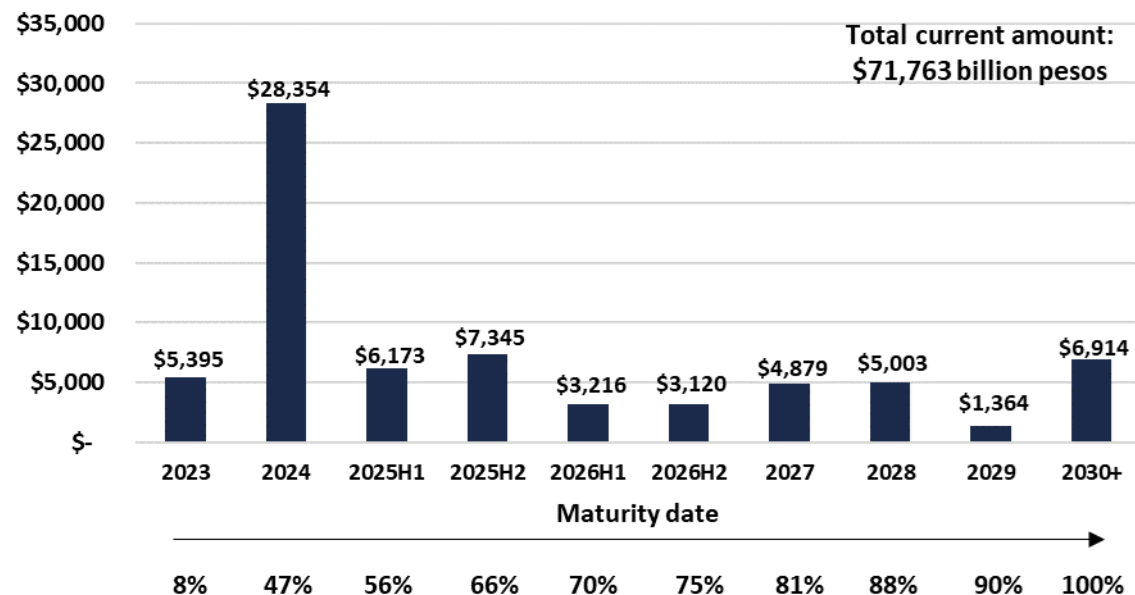
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# Maturity profile of derivative contracts linked to TIE 28

Starting to operate OIS contracts as soon as possible could significantly reduce the problem generated by the basis, considering that by December 2025, 66% of the current derivative contracts linked to TIE 28 will expire.

**Distribution of maturities of current derivative operations referenced to TIE 28<sup>1/</sup>**  
Percentage and billions of pesos



1/ Percentages below the horizontal arrow refer to the cumulative maturities relative to total outstanding swaps, by maturity date.

Source: Own elaboration with data from Banco de México, CME and LCH as of the end of October 2023.

# Actions to take to facilitate the swap conversion

## Modification of the swaps delivered in the conversion

- ✓ With the support of the three Clearing Houses (LCH, CME and Asigna), the swap conversion will be carried out in 2024.
- ✓ We are working with the Clearing Houses so that, in the conversion, the Forward Starting Swaps that are delivered (linked to Funding TIIE), start until January 2026. In such a way, in 2025 there would still be swaps linked to TIIE 28 (avoiding the basis for one more year).

## Temporary extension to operate new swap contracts linked to TIIE 28 until December 31, 2025, as long as the expiration date is less than or equal to said date

- ✓ In this temporary extension, any new contract operated during 2025, with a term greater than December 2025, must be OIS linked to Funding TIIE.

## Temporary permission to operate basis swaps after December 31, 2024 where one leg is TIIE 28

- ✓ This waiver will allow any institution or corporation to have time to cover its basis, and it will be valid until December 2025. The maturity date of these basis swaps does not have a restriction.

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# Funding TIE First



Initiatives such as **SOFR FIRST** or **SONIA FIRST** represent the **prioritization of contracts linked to risk-free reference rates (RFR)** instead of LIBOR for different market segments and particular financial products.



Similarly, in Mexico the **Funding TIE First initiative is launched with the aim of promoting the use of this reference rate** in different markets.

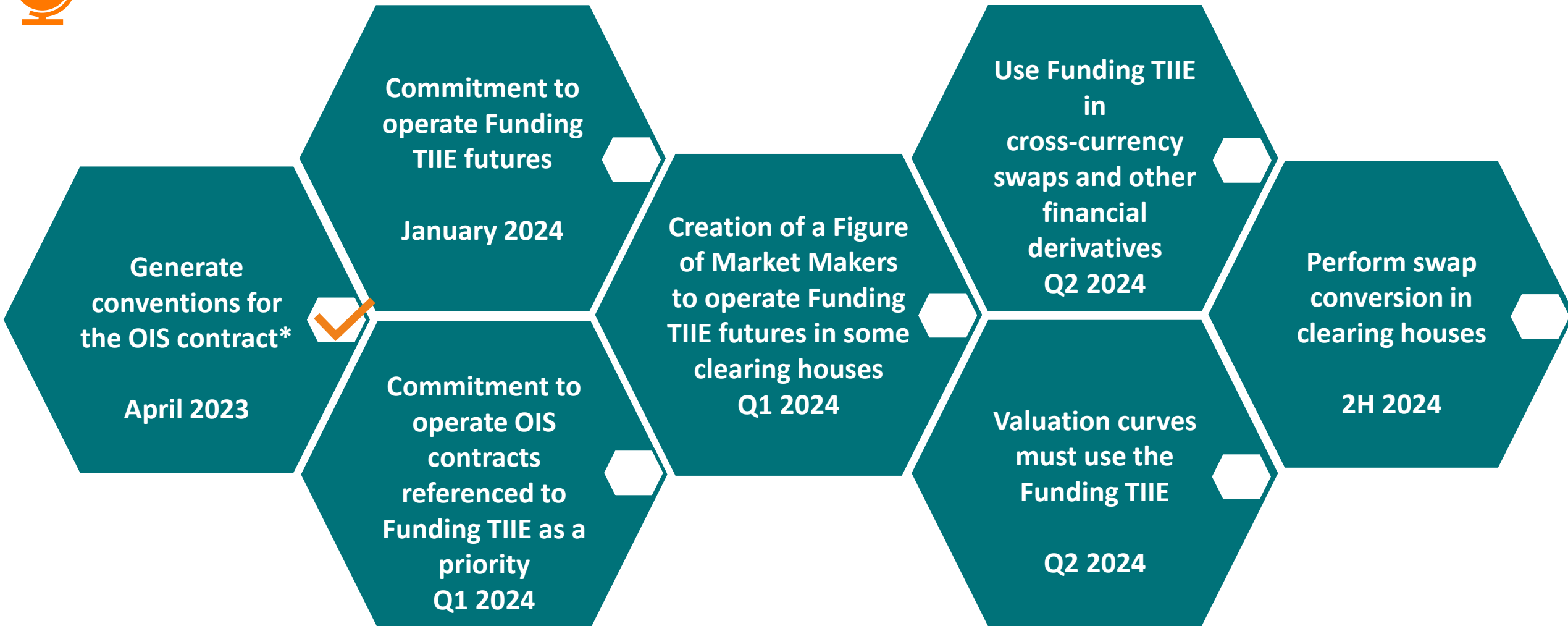


This initiative is **voluntary for each institution**, but given the risks that have been detected in the conversion of legacy derivatives linked to TIE 28 to OIS contracts linked to Funding TIE, it is considered that institutions have **every incentive to adopt the initiative**.

# Funding TIE First in the derivatives market



For the derivatives market, it is sought to achieve the following commitments:

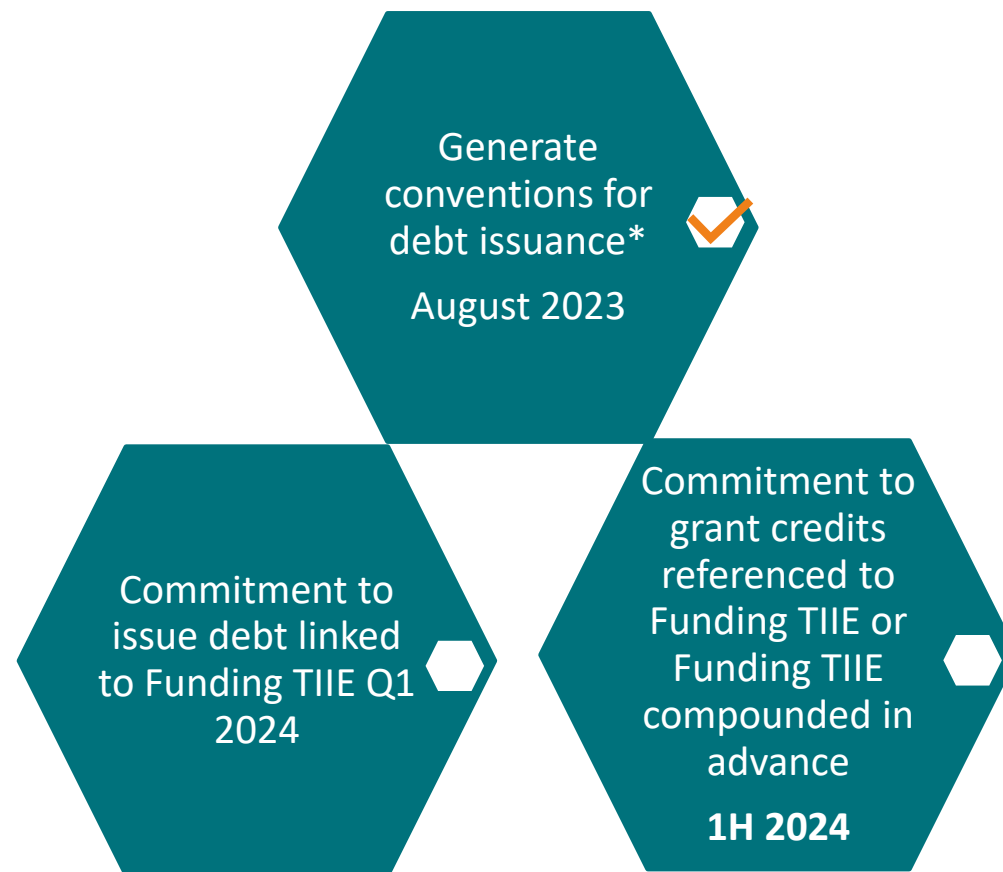


\*In April, 2023 was determined within the GTTR the conventions for OIS contracts and they were established in the Circular 4/2012 as a standardized swap starting from January 1st, 2025.  
Q = quarter, H = semester.

# Funding TIE First in other markets



Funding TIE First actions in other markets include:



\* In August, 2023 was determined within the GTTR the conventions for debt issuance.  
Q = quarter, H = semester.

## Additional Aspects of the actions to take



With the objective of formalizing the Funding TIE First initiative, all participants in the GTTR are requested to indicate to Banco de México their willingness to adopt the Funding TIE First initiative. Please indicate your position with respect to each of the hexagons on slides 13 and 14, **no later than December 19.**



In the event that an institution decides not to adopt the initiative (in whole or in part), please indicate the reasons why you make that decision (if any hexagon does not apply to your institution, please indicate so).



When submitting your responses, consider that as legacy contracts continue to increase in volume, the transition will be less smooth than it could be if everyone begins operating the Funding TIE First.

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## Final comments

- You are reminded that the final draft of Circulars 3/2012 and 14/2007 will soon be published in the Official Gazette of the Federation (DOF), in which the Funding TIE Compounded in Advance were added as reference rates for active and passive operations.
- Therefore, you will now be able to use these rates in new operations, as of their publication in the DOF.



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