December 2016

Dear Member,

We would like to ask you to comment on a draft standard term sheet for a GDP-linked bond, which has been developed by an *ad hoc* working group consisting of investment managers, lawyers from the private sector and economists from the Bank of England. Please find enclosed:

• The draft London Term Sheet for a GDP-linked bond

• An introduction to the term sheet

• An outline of the payment structure, which includes numerical examples

When reviewing this term sheet, in addition to your comments on the details of the term sheet more generally, we would like to bring to your attention the issue of revisions to official GDP data, which can be a source of uncertainty around the performance of the GDP-linked bond, and ask for you input in developing the approach to dealing with revisions that is most efficient and market-friendly.

Background: As discussed in the introduction to the term sheet, a preliminary estimate for a quarter’s GDP is typically produced around one or two months after the end of the quarter, a second estimate one month later and a first full set of quarterly accounts produced published after a further month. The data can often be revised further as GDP statistics for subsequent quarters are produced. To ensure that the third estimate, as published in the first full set of quarterly accounts, is available to be referenced in the GDP bond, the London Term Sheet proposes indexing the principal and coupon on the bond to GDP data with a six-month lag. This compares to a three-month lag for inflation-linked debt, where the reference index is measured at a higher frequency and generally not revised.

Once a particular coupon or principal payment has been made, based on the specified vintage of the GDP-data available at the calculation date for determining the payment on the GDP-linked bond, that payment is final. There is no later compensation for future revisions to GDP-data.

The principal of GDP-linked bonds is adjusted for the growth in nominal GDP by indexing it to the ratio, lagged by six months as described above, between the level of GDP at the relevant coupon or redemption payment date and the level of GDP at issuance (or Base Date as defined in the term sheet). There are two choices in determining these two levels of GDP:

a) Payments can be indexed to the latest available vintage of both the GDP at issuance/Base Date and the GDP for the payment date. For example, for a GDP bond with a 10 year original maturity and a 5 year remaining maturity, the principal repayment at maturity could be defined so that it fluctuates not only with the estimate for the level of GDP in five years’ time, but also with a re-estimation of the level of GDP at issuance.

b) Payments can be indexed to the latest vintage of GDP for the payment date and an historical level of GDP at issuance (or measured from the Base Date), which is not revised. This could be supported by a statistical agency that could create and keep up-to-date a chain-linked Nominal GDP Index by cumulating together the available sequences of third estimates of quarterly GDP growth. This would have the advantage of creating a measure of nominal GDP that, like consumer price indices used in inflation-linked bonds, is not revised. The main drawback is that payments would no longer be based on the most up-to-date measure of cumulative GDP growth since the bond was issued.

The attached term sheet is compatible with either choice for the link to nominal GDP. Along with your general comments on the term sheet, we would also be particularly grateful for your feedback on this issue of payment indexation and your choice from the two options outlined above.