



IBOR TRANSITION NEWSLETTER

Edition 9: August 2020

Welcome to our ninth Newsletter, which provides an update on the transition away from LIBOR and other Interbank Offered Rates (IBORs). With 2021 fast approaching, this Newsletter aims to raise awareness of key developments on an ongoing basis. We will continue to send this newsletter to you regularly during the period of transition. We hope you will find it helpful.

Please contact your Relationship Team if you have any questions or queries on the contents.

What has happened recently

The path towards transition of Sterling LIBOR products became clearer this month with a series of regulatory publications and statements. Late in July, the BoE Working Group on Sterling Risk Free Rates (BoE WG) [unveiled](#) several new milestones in an updated roadmap for 2020-2021. Most notably, these are: to cease new Sterling LIBOR linked linear derivatives by the end of Q1 2021; complete active conversion of cash products no later than Q3 2021; and where active conversion is not possible for loans to ensure that robust fallbacks are adopted. In a speech to the International Swaps and Derivatives Association (ISDA), delivered by Webinar, Edwin Schooling-Latter, Director of Markets and Wholesale policy at the FCA [stated](#) that the next four to six months are arguably the most critical period in the transition away from LIBOR. He also revealed that a decision about what will happen to the various LIBOR settings at the end of 2021 could be announced as soon as the final weeks of this year (see the "A closer look - How will LIBOR end?" section).

ISDA prepares to implement protocols

With a growing sense of urgency, the practical work to facilitate transition has continued to gather pace. Ahead of the launch of its IBOR Fallback Supplement and Protocol, ISDA has [written](#) to the affected Risk Free Working Groups to inform them that two weeks' notice ahead of the protocol launch will be provided during which market participants, and in particular regulated entities, will be able to privately adhere to the protocol "in escrow". This early adoption of the protocol signals commitment to the new fallbacks becoming widely embedded in legacy derivative contracts. ISDA's Board of Directors has subsequently issued a statement [endorsing](#) adherence and the BoE, FCA, and ARRC have also [issued](#) similar statements. As Edwin Schooling-Latter said, the FCA considers that signing of the Protocol satisfies the regulatory requirement for supervised firms to have a plan for cessation or material change for benchmarks such as LIBOR.

More reference materials become available

In support of these developments, more reference materials have been made available. The BoE WG [published](#) a questions and answers document covering the recently revised end Q3 2020 milestone for transition in loan markets. In addition, it made [available](#) a series of educational videos and supporting slides, which provide some background for those less familiar with LIBOR transition. Similarly, the ARRC [released](#) a SOFR starter kit that is comprised of three fact sheets on the history and background of SOFR, the key facts about SOFR, and SOFR next steps. An RFR indicator has been [launched](#) by ISDA providing a monthly snapshot of RFR trading activity in interest rate derivatives. Lastly, the ECB has [launched](#) a consultation on its proposal to publish a compounded euro short-term rate €STR with maturities ranging from one week to one year and a daily index to allow calculation of compounded rates over non-standard periods. This consultation closes on 11th September 2020.

ECB review and other international events

The ECB has [published](#) a report on preparations for benchmark reforms and good practices for banks, together with the results of an industry-wide assessment of bank's preparedness for the reforms. The report's assessment is that while banks are generally aware of the complexity of the reforms and the challenges involved, their level of preparation leaves room for improvement and they are generally behind schedule in implementing risk mitigation measures. The report also notes that banks have focused more on the transition from the euro overnight index average (EONIA) to the euro short-term rate (€STR) than on the risks associated with the reform of the euro interbank offered rate (EURIBOR).

Elsewhere, the Monetary Authority of Singapore (MAS) [published](#) a series of initiatives aimed at galvanizing greater activity and enhancing market confidence in the new Singapore Overnight Rate Average (SORA), complementing the transition roadmap set out earlier this year by the Steering Committee for SOR Transition to SORA (SC_STS).

A closer look

How will LIBOR end?

Exactly how and when LIBOR will end is now a key question. The general message is that LIBOR will neither cease, nor be deemed non-representative and therefore unfit for use by supervised entities, before the end of 2021. This is mainly due to an agreement in place between the FCA and the contributing panel banks. Nevertheless, the agreement neither provides absolute certainty of LIBORs end after that date nor guarantees that there won't be pre-announcements of LIBORs end ahead of 2022.

To be clear, there are two paths to the destination of LIBOR demise: either the FCA, will announce that it will deem a LIBOR to be non-representative at a certain point in the future - or the benchmark administrator (ICE Benchmark Administration) will provide - probably up to 12 months in advance – a notice of cessation. A non-representative announcement may or may not be accompanied by a specific effective date whereas a cessation announcement will be accompanied by a specific future date.

The risk to contracts

Ultimately whilst LIBOR may still continue to be published after the point of non-representativeness it can no longer be used or offered in products by supervised entities after this point. What is being termed "synthetic LIBOR" may be available for use in a small number of limited cases but for the avoidance of doubt will not be considered LIBOR when it comes to transition.

Any contracts that have not actively transitioned away from LIBOR - or have relevant fallbacks in place before the point of non-representativeness (even where LIBOR is still being published) - could end up relying upon on a potentially volatile non-representative and unregulated reference rate. These contracts could then face challenges in being renegotiated prior to actual cessation.

Credit adjustment spread

Where relevant fallbacks do apply, these are triggered on the date a LIBOR becomes non-representative or ceases. These effective dates will be pre-announced, and the announcement date will have commercial implications as it determines the period used in the calculation of the credit adjustment spread (CAS) that is added to the risk free rate. CAS is calculated for each IBOR tenor being replaced and reflects the appropriate term-premia and bank credit risk, which risk-free rates do not as they are overnight.

The recommended approach for calculating the credit adjustment spread which is now emerging in markets, is to take the median of the historical difference between the LIBOR in the relevant tenor and the relevant compounded risk free rate over a five-year period. When the pre-announcement of a cessation or non-representativeness effective date is made, the day before the announcement is used to determine the end date for the historical period used to calculate the CAS. The CAS, however, will not be implemented until the relevant effective date, which could be some time in the future.

Dates could move

A further dimension to consider is that the announcements of cessation of LIBOR could be made before end-2021. This could occur, even if the cessation or loss of representative status is not expected until the panel banks leave voluntarily at or after the end-2021 (or another date for panel bank departure). In his July speech, Edwin Schooling-Latter, said:

"As I have said previously, decisions about what will happen to the various LIBOR settings at the end of 2021 could be announced as soon as the final weeks of this year. There could be announcements by the end of 2020 of cessation of settings at the end of 2021. There could also be announcements that it will no longer be possible to produce LIBOR settings on a representative basis from the end of 2021. Firms need to be prepared for these possibilities."

In summary, there is much to consider in terms of how and when LIBOR ends. Complexities, and the lack of certainty over timing of events, are key reasons why clients should consider active transition of LIBOR referencing contracts versus reliance on fallbacks.

For additional information from Lloyds Banking Group on the transition from LIBOR, please see our website which includes our 'LIBOR: the countdown to 2021' paper and latest reference materials here:

[Click here to visit our website >](#)

Please let your Relationship Manager know if you have any feedback or suggestions.

Yours sincerely



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