Edition 3: February 2020

Welcome to our third Newsletter dealing with the planned transition away from LIBOR and other Interbank Offered Rates (IBORs). With 2021 fast approaching we aim to keep you aware of key developments, and plan to send this newsletter to you regularly throughout the period of transition. We hope you will find it useful.

What has happened recently
In a speech to the International Swaps and Derivatives Association (ISDA)/SIFMA Asset Management Group Benchmark Strategies Forum earlier this week, Andrew Hauser, Executive Director for Markets at the Bank of England (BoE) outlined two new initiatives for LIBOR transition:

- publication of a compounded SONIA index from July 2020 to simplify the calculation of compounded SONIA interest rates. The BoE has prepared a paper on the options for this index, inviting comments by 9 April 2020
- a progressive increase in the haircuts[1] applied to LIBOR-linked collateral deposits with the BoE to 100% by the end of 2021, so that by that date they will no longer be eligible to support borrowing.

At the same conference Edwin Schooling-Latter, Director of Markets and Wholesale Policy at the FCA continued the theme that the time for change is now and noted that with the move to SONIA now embedded in the bond market and a clear direction set for derivatives, the key challenge that remains is to embed the use of SONIA into loan markets. In looking forward to the end of 2021 he said the preference is to be able to provide markets with sufficient warning and formally announce LIBOR's cessation in advance of the cessation date itself.

ISDA has announced a new consultation on what is known as "pre-cessation". The proposal is that fallbacks to an adjusted Risk-Free Rate apply to all relevant derivatives following the permanent cessation of an IBOR or a 'non-representative' pre-cessation event, **whichever occurs first**.

Under this scenario, a single protocol would also be launched to allow participants to include both pre-cessation and permanent cessation fallbacks within their legacy derivatives trades. The new consultation is open until 25 March 2020 with the results and next steps expected to be published in late April or early May. This re-consultation follows the release of letters earlier this month from the FCA and the LIBOR administrator ICE Benchmark Administration about the length of any period in which a non–representative LIBOR might continue to be published prior to cessation.

In the US the Alternative Reference Rates Committee (ARRC) welcomed an announcement that the government sponsored enterprises Fannie Mae and Freddie Mac will stop accepting adjustable-rate mortgages (ARMs) based on LIBOR by the end of 2020, and that they plan to accept ARMs based on the Risk-Free Rate, SOFR, from later in 2020. As a reminder, we reported in our earlier newsletters that the Sterling Risk-Free Rate Working Group has a target for no new Sterling issuance of LIBOR-based cash products maturing after 2021 from the end of Q3 this year.

In Europe work on managing the discontinuation of EONIA on 3rd January 2022 continues, with the Working Group on Euro Risk-free Rates (EU RFR WG) publishing a further report on the transition from EONIA to €STR in the cash and derivative markets. It highlights that contracts referenced to EONIA with maturities beyond 3 January 2022 entail significant risks and that market participants should replace these with €STR products and reduce their legacy EONIA exposures. The report includes some practical suggestions on how this transition should be managed.

Also in Europe, the European Insurance and Occupational Pensions Authority (EIOPA) has published a technical discussion document outlining important considerations for the use of Risk-Free Rates in fund valuation and capital calculations.

KEY RECENT DEVELOPMENTS	
Global	• ISDA announces further consultation on pre-cessation
UK	• BoE initiatives to support LIBOR Transition
Europe	• EU RFR WG report on transfer of EONIA Liquidity to the €STR • EIOPA discussion paper on IBOR Transition
US	• ARRC welcomes decision to cease LIBOR mortgages

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

Cris Kinrade
IBOR Transition Programme
Lloyds Bank Commercial Banking

Please feel free to get in touch with your relationship team to discuss any questions you may have. We would also encourage you to consult with your own advisors about these changes and any potential impacts for you.

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[1]In financial markets, a haircut refers to a reduction applied to the value of an asset