



# IBOR TRANSITION NEWSLETTER

Edition 7: June 2020

Welcome to our seventh 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

No major new COVID-19 related delays to interim milestones were announced in June. Instead, the PRA and FCA [restored](#) full supervisory engagement with LIBOR transition after a period of hiatus due to COVID-19. Focus simultaneously fell back to some of the key priorities [outlined](#) by both the FCA and Bank of England back in April. More specifically, the Working Group on Sterling Risk-Free Reference Rates (BoE WG) published a [paper](#) on the identification of "tough legacy" contracts being those that do not have robust fall backs and prove unable to be amended ahead of LIBOR discontinuation.

The BoE WG paper highlights that "tough Legacy" characteristics vary across asset classes/transaction types. For example there are scenarios where 1) contracts form part of complex transactions or arrangements; 2) distribution is broad and there may be additional complications with obtaining the necessary consent; and 3) retail counterparties are involved. The paper goes on to propose that the UK consider legislative proposals in relation to "tough legacy" contracts, but recognises that there is no guarantee that a legislative solution will materialise and that any such potential solution may not be economically neutral or suitable for certain contracts. Other solutions to the tough legacy problem should be pursued in parallel, such as LIBOR being stabilised via a so called 'synthetic methodology'. Furthermore, the overarching view is that firms should continue to proactively remove LIBOR dependencies from their contracts before the end of 2021. The paper provides another step toward bridging the issues created by "tough legacy" contracts.

Separately, the International Swaps and Derivatives Association (ISDA) [published](#) a new fact sheet entitled "Understanding IBOR Fallbacks" explaining what the individual fallbacks are and why they are necessary. Fallbacks are the replacement rate that would apply to trades referencing a benchmark. These will take effect if the relevant benchmark becomes unavailable while market participants continue to have exposure to that rate. Likewise, for derivatives that only reference LIBOR, the fallback will take effect following a determination by the FCA that LIBOR in the respective currency is no longer representative of its underlying market, even if it continues to be published.

As a reminder, ISDA are due to publish a supplement to the 2006 ISDA definitions in July to incorporate new fallbacks for derivatives that reference certain key IBORs, together with a protocol that will allow market participants the choice to incorporate the revisions into their legacy trades. Given fallbacks in cash products are also under consideration, the factsheet is an equally worthwhile reference material for those without derivatives contracts.

In addition to the ISDA reference materials, the Alternative Reference Rates Committee (ARRC) in the US [updated](#) its Frequently Asked Questions to provide further clarity on how the COVID-19 pandemic influences LIBOR transition. The new addition reaffirms the ARRC's commitment to the end of 2021 deadline for transition. Aside

from the COVID-19 update, the Frequently Asked Questions continue to provide an invaluable resource for information on USD LIBOR and broader transition.

The FICC Markets Standard Board (FMSB) [report](#) titled "LIBOR transition: Case studies for navigating conduct risk" was another document to be made available. As a guide to conduct around transition, the report provides good practical case studies to support firms when considering the risks to fairness and effectiveness as the market moves to risk-free rates as more sustainable and representative benchmarks. Notwithstanding being written with financial firms in mind, the case studies outlined in the report should prove equally helpful to commercial banking clients.

Besides new reference materials, a [published](#) summary of responses to a BoE consultation showed near-unanimous support for the provision of a compounded SONIA index. Similarly, the report noted that there was a high degree of support for the proposed methodology, which was viewed to promote international consistency. Looking ahead, the BoE expects to begin publication of the index sometime in early August. The BoE also confirmed that there are no plans at this stage to produce any additional indices or data.

## A closer look

### IBOR transition in CHF, JPY, and EUR

Many of the developments discussed over recent months have been about USD and GBP LIBOR, but the effort to move away from interbank overnight lending rates (IBORs) is international. The path towards transition, however, is not consistent amongst the remaining three less mentioned active LIBOR benchmarks. Deadlines differ, as do the processes and the types of benchmarks proposed, despite a shared commitment from regulators to cease LIBOR by the end of 2021.

In the case of CHF LIBOR, the situation closely resembles that for USD and GBP. Swiss authorities remain fully committed to LIBOR cessation. A risk-free reference rate called the Swiss Average Rate Overnight (SARON) has been established and a compounding approach is being adopted. FINMA, the Swiss regulator, expects substantial progress on replacing CHF LIBOR-based cash products with those SARON based by the end of 2020. In terms of derivatives, SARON is to be documented by ISDA as the recommended risk-free rate under a fallback scenario.

For JPY LIBOR, transition takes a multiple rate approach. JPY LIBOR is anticipated to cease, but a reformed Tokyo Interbank Overnight Rate (TIBOR) will stay in place. This is in tandem with the Tokyo Overnight Average rate (TONA), the recommended risk-free rate for JPY. TONA has been referenced by ISDA as the standardised risk-free rate under fallback scenarios involving both TIBOR and JPY LIBOR. Prototype risk-free term rates began publication in May and their further development is a priority. Meanwhile, in its June Dear CEO letter, the Bank of Japan requested major financial institutions submit targets for the termination of new issuance and contracts referencing LIBOR beyond 2021 by July 2020.

Preparations for the end of EURO LIBOR are also underway. As with JPY, the reformed Euro Interbank Overnight Rate (EURIBOR) will be run in parallel with a risk-free rate – the euro short-term rate (€SSTR). €STR was launched in October 2019 and reflects the daily wholesale euro unsecured overnight borrowing costs of euro area banks. As EURIBOR will remain in place, the near-term priority is to fully replace the previous risk-free benchmark - the Euro Overnight Index Average (EONIA) - with €STR. The ISDA recommended fallback rate for both EURO LIBOR and EURIBOR is €SSTR. Early 2021 will see continued consultations on how to best handle €STR fallback mechanics for cash products.

The one common theme between both JPY and EUR LIBOR transition, is although IBORs will still be in place, work to ensure appropriate fallbacks referencing risk-free rates is a major priority ahead of the end-of-2021 deadline for the cessation of LIBOR. As a result, clients with related currency exposures will still need to familiarise themselves with how risk-free rates will be used in the future even if they are not transitioning to a new rate immediately.

## Forthcoming joint event with ACT

Lloyds Bank will be co-hosting a webinar with the Association of Corporate Treasurers (ACT) on 1 July at 12:30. Speakers from Lloyds Bank will discuss recent transition developments during the COVID-19 crisis and products available to support the move away from LIBOR. Shaun Kennedy, Treasurer from Associated British Ports will also share his thoughts on transition and there will be time available for Q&A. If interested, please don't hesitate to [register now](#).

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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