Edition 4: March 2020

Welcome to our fourth Newsletter, which provides an update on the transition away from LIBOR and other Interbank Offered Rates (IBORs). With 2021 fast approaching, we aim to raise awareness of key developments and plan to send this newsletter to you regularly during the period of transition. We hope you will find it helpful. Please contact your Relationship Manager if you have any questions on the contents of this Newsletter.

What has happened recently

Recent news has been dominated by the response to the Coronavirus and its effect on the global economy. The UK Financial Conduct Authority (FCA) issued a short statement on 25 March saying that whilst the deadline for moving away from LIBOR remains the end of 2021, there may be changes to the timing of some of the key steps that need to be taken before then and that further updates will be provided as soon as possible.

So far the only other direct impact of Coronavirus upon IBOR Transition has been the decision by the International Swaps and Derivatives Association (ISDA) to extend the deadline for responses to its consultation on pre-cessation triggers from 25th March to 1st April, in recognition of the fact that "other topics will understandably take more time to address in the current environment". Similarly to the approach adopted by the FCA, ISDA’s target for adoption of fallbacks into both new and legacy trades by the end of the year currently remains unchanged.

The FCA has also issued a statement for market participants explaining how announcements of either the pre-cessation or cessation of LIBOR will be made, ensuring that all market participants are given notice at the same time. Within the statement they also indicated that whilst they do not expect LIBOR to cease or become non-representative before the end of 2021, announcements could be made ahead of that point.

Following the announcement reported in our February Newsletter that the Bank of England (BoE) will publish a compounded SONIA index from the end of July, this month has seen the publication of compounded indices for both the SOFR (USD) and SARON (CHF) risk-free rates. In a statement on bond conventions the UK's Working Group on Sterling Risk-Free Reference Rates (Sterling Working Group) welcomed the proposed SONIA index and its implications in terms of influencing an issuer’s decision on whether to adopt the observation shift approach instead of the current lag approach for interest calculation in the SONIA bond market.

The Sterling Working Group’s Loan Enablers Taskforce has published an indicative roadmap as a guide for lenders, borrowers and infrastructure providers in meeting the target of ceasing issuance of sterling LIBOR-based cash products by the end of Q3 2020 where maturity is after the end of 2021. At this time we await clarification about any change in timing due to Coronavirus.

HMRC published draft guidance and a consultation seeking views on the taxation issues arising from the withdrawal of LIBOR to ensure that where tax legislation makes reference to LIBOR it continues to operate effectively.

In the US the Alternative Reference Rates Committee (ARRC) sent a letter to the US Treasury Department and the Internal Revenue Service describing the proposed regulations on IBOR transition as "comprehensive" and "addressing most of the concerns raised by the ARRC in a manner that gives significant flexibility to taxpayers seeking to transition away from IBORs."

ARRC also released a proposal to enact legislation in New York State aimed at minimising both legal uncertainty and adverse economic impacts of LIBOR transition for existing contracts that either i) do not have fallback language to address a permanent LIBOR cessation, or ii) have language that could dramatically alter the economics of contract terms if LIBOR is discontinued. The proposal is for New York State legislation because a substantial number of financial contracts that reference USD LIBOR are governed by New York State law.

In Europe the Working Group on Euro Risk-free Rates (EU RFR WG) remains focussed upon the transfer of liquidity from EONIA to €STR ahead of its discontinuation in January 2022. It has published a factsheet covering the implications of the change for products, models, legal, accounting and risk management, together with a factsheet on EURIBOR fallbacks in the wider context of interest rate benchmark reform.

In Japan, the Japanese Financial Services Agency (JFSA) and the Bank of Japan (BoJ) have conducted a survey of financial institutions' preparedness for transition and are now considering setting specific core targets and conducting on-site reviews to monitor progress.

KEY RECENT DEVELOPMENTS	
Global	• ISDA extend consultation on pre-cessation in response to Covid-19
UK	• Sterling Working Group welcomes compounded SONIA index • Sterling Working Group roadmap for discontinuation of LIBOR-based cash lending • FCA statement on contractual triggers • HMRC draft guidance and consultation on implications of LIBOR withdrawal • FCA statement on the impact of coronavirus upon IBOR Transition
Europe	• EU RFR WG factsheets on EURIBOR fallbacks and transfer from EONIA to €STR
US	• ARRC welcomes publication of SOFR averages and a SOFR index • ARRC proposals for legislative relief • ARRC letter to Treasury and IRS on proposed tax legislation
Other Regions	• JFSA and BOJ survey on use of LIBOR • SIX announce publication of compounded SARON indices

A closer look

Sterling Overnight Index Average (SONIA)

In April 2017 SONIA was recommended as the alternative benchmark for GBP LIBOR by the Sterling Working Group. The reasons for this included that it is anchored in active, liquid underlying markets and is likely to be stable and correlate with BoE base rate.

It is administered by the BoE and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions. It is published the following working day at 9am.

SONIA is an overnight rate, whereas LIBOR is forward-looking over various terms (e.g. 1 month, 3 month), with the interest rate (and hence interest payable) for the relevant term known at the outset. Also, LIBOR includes a measure of bank credit risk and SONIA does not. This means:

- SONIA has tended to track lower than LIBOR[1]. As an example during 2019 daily differences between SONIA and 3 month LIBOR ranged between 0.0448% and 0.2273% with average difference over the whole period being 0.1014% lower

- For SONIA-based facilities, interest payable over a period is typically calculated by daily compounding a series of overnight rates with the interest due being calculated near the end of the relevant period. In order to make this process operationally easier there is normally a time lag of a few days to allow the interest amount to be known before payment is due

There is an initiative to develop Term SONIA rates and as covered in our January newsletter, the case use report from the Sterling Working Group indicated the cases where it could be used would be limited, and gave examples of certain trade finance products and lower value loans to a wide range of smaller borrowers. Provisional Term SONIA rates are due to be produced from the end of July, with some test rates being produced beforehand. We await clarification about any change in timing due to Coronavirus.

If you would like more information about SONIA you can visit the BoE website or speak to your Relationship Manager.

Next month we will take a closer look at the USD preferred alternative rate, SOFR, in more detail.

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]Past values are no assurance or indicator of the future performance of any reference rates.