

LIBOR Transition

Market update:
April 1-15, 2021

259
805 days to **December 31, 2021**
June 30, 2023

1 Highlights

LIBOR transition on the Hill

What happened? The House Financial Services Committee (HFSC) subcommittee on Investor Protection, Entrepreneurship and Capital Markets held a virtual [hearing](#) on the end of LIBOR. Lawmakers heard testimony from representatives of the [Fed](#), [US Department of the Treasury](#), [Securities and Exchange Commission](#), [Office of the Comptroller of the Currency](#) and [Federal Housing Finance Agency](#). Addressing the risks associated with legacy LIBOR contracts without or containing inadequate provisions to address LIBOR's permanent cessation quickly became a focal point of the hearing.

The Fed's Jerome Powell, Treasury Secretary Janet Yellen, SIFMA and other industry groups have voiced their [support](#) for such legislation at the federal level. A [draft](#) of such a legislation, titled the "Adjustable Interest Rate (LIBOR) Act of 2021," has now been made public by the committee. The bill is modeled closely after a legislative solution put forward by the Alternative Reference Rates Committee (ARRC) in New York State, which was only recently [signed into law](#) by state governor Andrew Cuomo. Legislation at the federal level would naturally cover a larger set of affected contracts. In explicitly preempting any state solution, it would also promote consistency and clarity in addressing troublesome legacy LIBOR contracts.

Federal legislation would also address issues associated with existing laws such as the Internal Revenue Code and the Trust Indenture Act of 1939. The draft presented as part of the hearing includes provisions that seek to limit conflicts with such laws.

The committee indicated it would seek to interact with industry groups and other stakeholders to refine the draft of the bill.

1 – Highlights

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Our take: The hearing commenced with an energetic opening courtesy of committee chair Brad Sherman (D-CA), who tried his best to interject some levity into a technical topic of high importance for the financial industry, but admittedly limited opportunity for political point-scoring. The subsequent testimony of regulators and questioning by lawmakers provided little in terms of new information to those familiar with LIBOR transition. The agencies reiterated many of the known talking points, once again confirming that the transition from LIBOR ranks high on the list of supervisory priorities.

What did become clear is that a federal legislative solution for hard-to-amend legacy LIBOR contracts is gaining momentum with bipartisan support. There are clear advantages to a federal bill, which can address potential conflicts specifically with the Trust Indenture Act. We expect industry organizations, agencies and market participants alike to continue their vocal support of the bill, which at this point seems to have very few opponents.

Of course, nothing in politics is certain. Momentum or not, market participants should continue to view a legislative solution as a risk mitigating backstop of last resort, rather than a transition strategy. The prospect of the bill becoming law doesn't erase the advantages of a proactive transition wherever possible, beginning with the ability to retain control over the economic outcome of amending or renegotiating a contract. Further, federal legislation, while far reaching, would be limited to contracts governed under US law, leaving parties to USD LIBOR contracts subject to other jurisdictions without this particular seatbelt.

Credit-sensitive alternatives

What happened? The Loan Syndications & Trading Association (LSTA) published a [market advisory](#) (member access only) putting forward sample language describing a fallback to a credit-sensitive rate, designed to be included as an optional step in hardwired fallback language in syndicated and bilateral business loans. The provided language offers sample definitions of four such credit sensitive rates that market participants may consider: AMERIBOR, ICE Benchmark Administration's (IBA) Bank Yield Index, the Bloomberg Short-Term Bank Yield Index and the IHS Markit Credit Rate.

A credit-sensitive alternative to SOFR as replacement for USD LIBOR was also a point of discussion at the recent hearing on LIBOR's end in front of a subcommittee of the US House Committee on Financial Services, attended by representatives from several US regulatory agencies. Both lawmakers and regulators acknowledge concerns by a number of smaller institutions, who suggested that SOFR as a lending rate did not adequately reflect their funding costs, especially in times of stress. Regulators reiterated their position that market participants were free to choose a replacement for USD LIBOR that met their specific needs, provided such a rate was sufficiently robust, banks exercised appropriate due diligence in their selection of such a rate and included adequate fallback provisions in contracts referencing such rates.

In response to the draft bill intended to address legacy LIBOR based contracts discussed at the hearing, the Bank Policy Institute (BPI) [suggested](#) that any such



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legislation should allow for a credit sensitive spread to be applied to the stipulated replacement rate, i.e. SOFR.

Our take: The thought of a credit-sensitive benchmark, or add-on, to SOFR continues to sound appealing to bank treasurers — and potential options continue to emerge. In addition to the set of rates referenced in LSTA's advisory, the Across-the-Curve Credit Spread Index is moving closer to [publication](#) as well.

In the long run, the USD lending market appears destined to evolve into a multirate environment, with SOFR coexisting alongside any number of credit sensitive alternatives. In the near term, however, we see most firms prioritizing the establishment of SOFR lending capabilities. As in the case of a potential SOFR term rate, market participants don't have the luxury of waiting for credit-sensitive rates to become established. In light of regulatory pressure to end the issuance of new LIBOR-based products, SOFR should represent the most practical, direct path to meeting those expectations.

What remains to be seen is what type of appetite corporate borrowers may have to enter into contracts employing credit-sensitive rates. Early indications are that the reception will be a cool one, at best. Edwin Schooling Latter, Director of Markets and Wholesale Policy at the UK's Financial Conduct Authority (FCA) suggested as much in remarks at a recent [industry event](#), expressing doubt that sophisticated borrowers would be willing to assume the risk of a rising benchmark rate in times of economic stress. Some lenders are bound to view the regulators' concession that banks should be free to choose an appropriate benchmark as a green light to turn to credit-sensitive rates. But they might quickly realize that regulatory expectation doesn't represent the biggest roadblock to employing such rates. After all: The customer is always king.

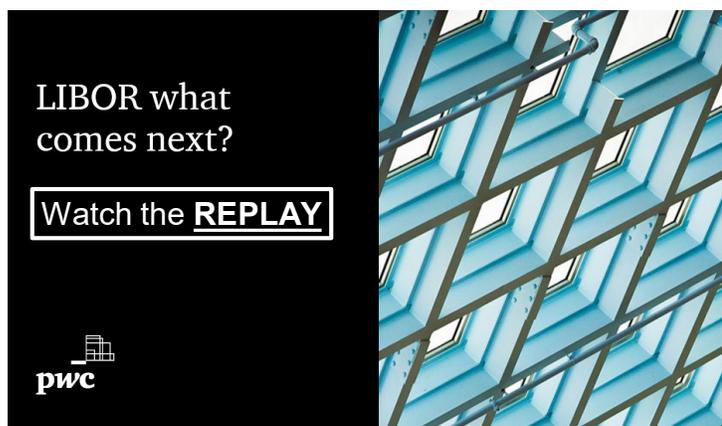
Preemptive conversion of cleared LIBOR based derivatives

What happened? The London Clearing House (LCH) [announced](#) a series of fallback and conversion fees for contracts based on GBP, CHF, JPY or EUR LIBOR, with the intent of encouraging proactive transition. Beginning in September, the LCH will charge a monthly fallback fee of £5 for outstanding LIBOR-based cleared contracts. In addition, the LCH will charge a fee (not yet specified) for any contract that will be converted as part of its preemptive conversion of existing cleared LIBOR trades into RFR-based swaps with characteristics consistent with new OIS swaps. The intent is to preempt the fallbacks developed by the International Swaps and Derivatives Association (ISDA), which would result in swaps using different conventions than the current market conventions for OIS swaps, creating bifurcation and operational complexities. The conversion is scheduled to take place on December 3 for CHF, EUR and JPY LIBOR based trades, and on December 17 for GBP LIBOR based trades.

The Chicago Mercantile Exchange (CME) [confirmed](#) it would facilitate a similar preemptive conversion of CHF and JPY LIBOR based trades on December 3 and GBP LIBOR trades on December 17. No fees have been announced as of yet, although the CME noted it would publish additional material detailing its approach in May.

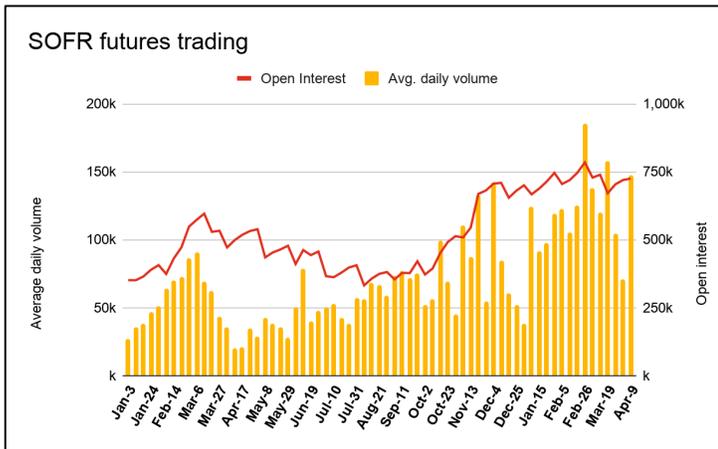
Our take: Last month the UK's FCA suggested that progress toward transitioning away from LIBOR should impact the compensation of those who are accountable. Now, the LCH has added another monetary incentive. Per contract fees could add up quickly — and we still don't know what the conversion fee might be. It also remains to be seen whether the CME's final proposal will include similar economic incentives to actively transition contracts prior to LIBOR's cessation, or even prior to a facilitated conversion shortly before LIBOR's actual cessation date.

We wouldn't be surprised if firms do in fact look to accelerate the proactive transition of LIBOR exposures, potentially motivated by the receipt of a first invoice for fallback fees for the month of September. At the same time, some cleared trading will remain dependent on firms' customers activities and the resulting hedging needs. Nevertheless, if firms look to accelerate the shift away from LIBOR during the second half of this year, liquidity in hedging products could be impacted. Market participants will need to monitor a possible increase in any cost increases as a result of such a shift in liquidity.

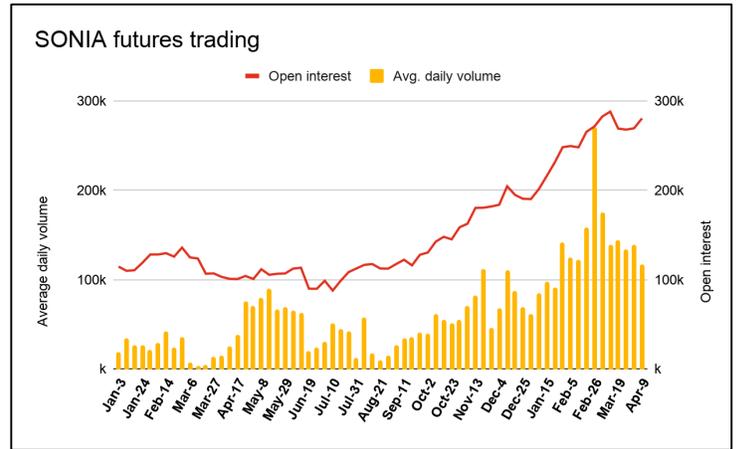


2 RFR adoption: Derivatives

Futures and options



Source: CME, ICE (accessed April 12, 2021)



Source: CME, LCH, ICE (accessed April 12, 2021)

Our take: The CME [summarized](#) the record setting SOFR futures trading activity in the first quarter of 2021. Over 500 global parties are now participating in the trading of SOFR futures at the CME, which has specifically seen trading activity increase in non-US time zones.

Trading activity in SONIA futures remains elevated but hasn't been able to sustain the upward momentum seen in the beginning of the first quarter.

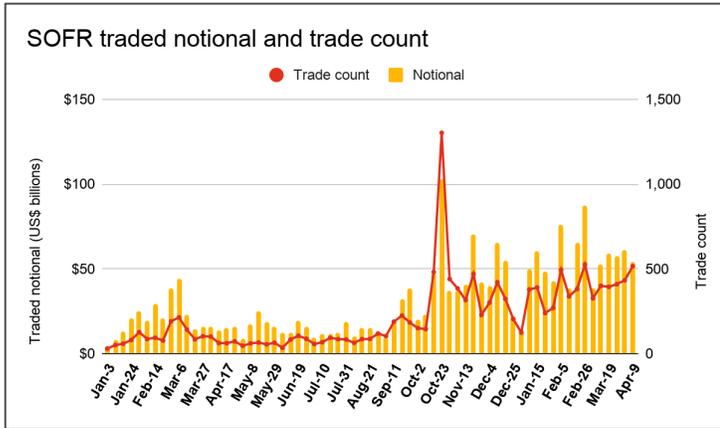
ISDA IBOR Fallbacks Protocol adherence

(as of April 15, 2021)

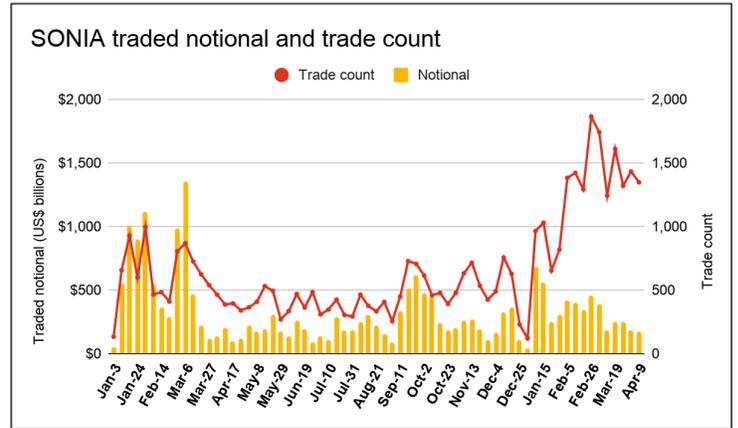
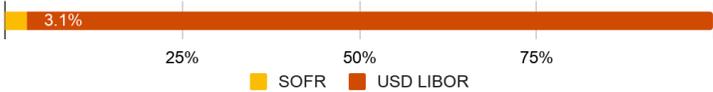
- 13,828 total entities (up from 13,681)
- 1,614 sign-ups on or after the effective date
- 29 out of 30 G-SIBs (unchanged)

Source: ISDA

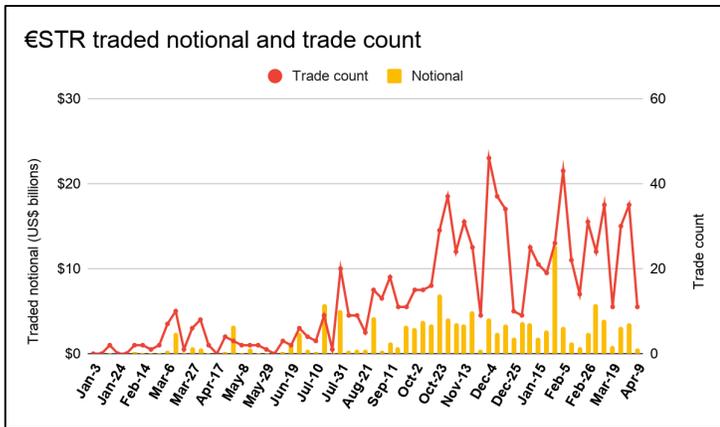
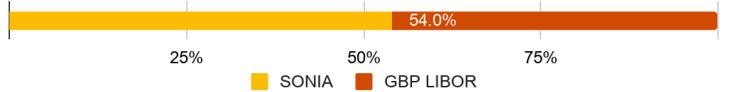
Swaps trading



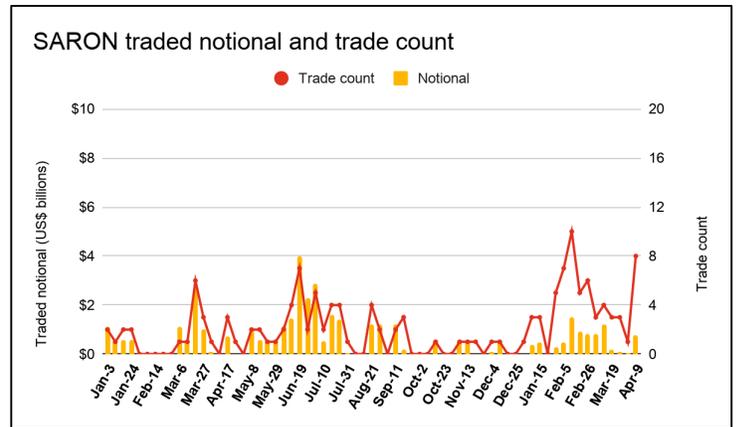
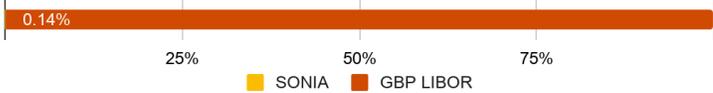
Total Notional (April 2021) - SOFR vs. USD LIBOR



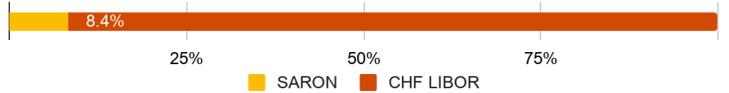
Total Notional (April 2021) - SONIA vs. GBP LIBOR



Total Notional (April 2021) - €STR vs. EURIBOR

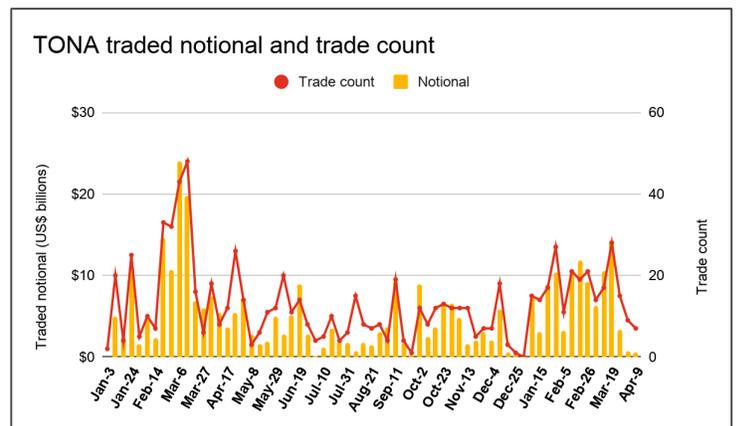


Total Notional (April 2021) - SARON vs. CHF LIBOR

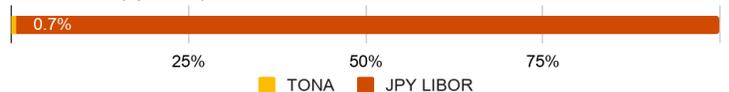


Our take: As of yet, the passing of the WG on Sterling RFRs' target date for an end to the issuance of new GBP LIBOR products has not translated into a significant shift toward SONIA in the GBP swap markets. While trading in SONIA swaps certainly is more robust and further along than trading in other RFRs, LIBOR continues to account for about half of all notional in GBP swaps. Some of that activity is likely related to the ongoing risk management of LIBOR based exposures, one of the noted exceptions to the expected end of LIBOR use.

Whether it's SONIA, SOFR or any of the other RFRs slated to replace LIBOR in other currencies, it is becoming clear that the shift away from LIBOR will continue to happen gradually. Liquidity is bound to increase over time as a result of the ongoing shift to RFRs in all product types, rather than as the result of a single event.



Total Notional (April 2021) - TONA vs. JPY LIBOR



Source: analysis.swapsinfo.org (interest rate and credit derivatives weekly trading volume): Week ending April 9, 2021, accessed April 12, 2021.

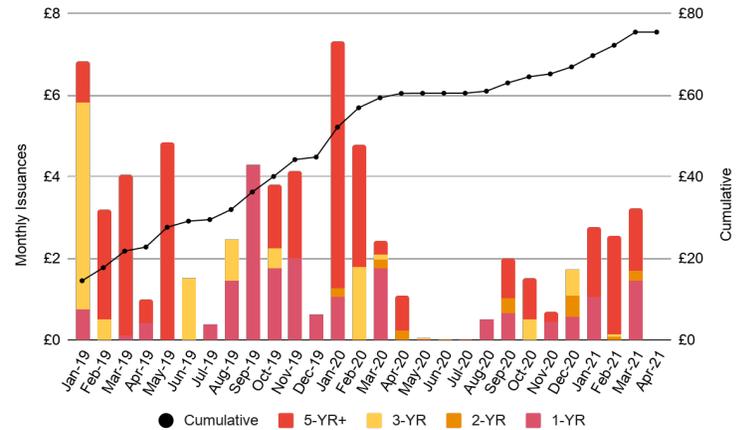
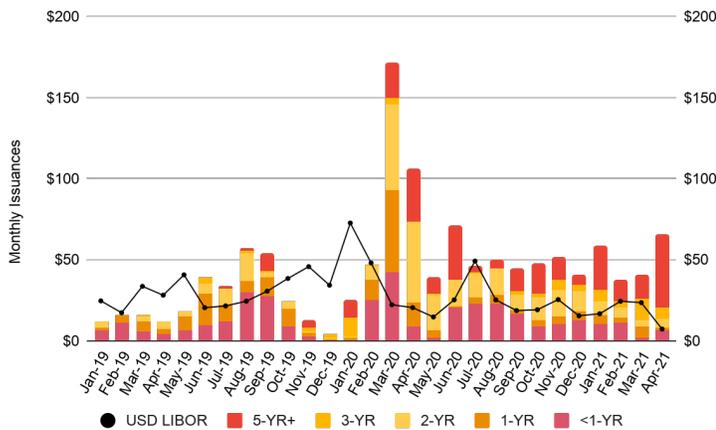
3 RFR adoption: Cash products

FRN issuances (as of April 15, 2021)

Source: Bloomberg. Includes callable issuances.

USD FRN issuances (in billions)

SONIA FRN issuances (in billions)



Our take

Just two weeks in, April has already become the most active month for SOFR issuances in about a year. A total of just over \$65 billion in instruments tied to SOFR were issued, albeit just over two-thirds of the total came in the form of callable securities. More importantly, we are now finally seeing a more pronounced reduction in the issuance of instruments tied to USD LIBOR. With just over \$7 billion in issuances, April is on track to set a record low for new USD LIBOR issuances since we started tracking such issuances in January of 2019. Even more importantly, the vast majority of USD LIBOR issuances have maturity dates earlier than June 2023, the planned end date of USD LIBOR publication. Further, all issuances with maturity dates extending beyond June 2023 have come from issuers based outside of the US.

Notable cash product issuances and other RFR adoption¹

RFR	Company	Detail	Resources
SOFR	BMW	Entered into a \$1.25 billion SOFR-linked swap, which is thought to be the largest for a European corporate.	Press coverage
	Yes Bank	The Indian bank secured trade borrowing based on SOFR, reportedly the first onshore foreign currency borrowing based on SOFR in India.	Press release
	EBRD	Reported strong investor interest for a \$850 million 5-year SOFR FRN.	Press release
	Freddie Mac	Continued the issuance of multifamily K-Deals backed by floating-rate multifamily SOFR-based mortgages.	Press release
SONIA	Aviva	Initiated a consent solicitation with the intent to switch a series of FRNs from GBP LIBOR to SONIA.	Reg filing
	West Bromwich Building Society	Notified holders of its Kenrick No. 3 RMBS that its consent solicitation to switch the reference rate from GBP LIBOR to SONIA was successful. Approval for the change was obtained by means of negative consent.	Notice to bondholders
THOR	Kasikornbank (KBank)	Finalized a credit facility and corresponding cross-currency interest swap based on THOR, thought to be the first such transaction since THOR's initial publication in April of 2020.	Press release

For additional details on employed conventions and other parameters of recent RFR-based loans, see the Loan Market Association's (LMA's) [regularly updated list](#) of RFR referencing syndicated and bilateral loans.

¹ Please note: This information has been obtained from publicly available sources.

4 Publications at a glance

National working groups

Alternative Reference Rates Committee (ARRC)

- [Updated](#) its recently released progress report on the transition from USD LIBOR, which includes revised estimates of current USD LIBOR exposures.

WG on Sterling RFRs

- Published an [updated version](#) of its roadmap and priorities for 2021.
- Published its [newsletter](#) for March 2021.

NWG on CHF Reference Rates

- Published an [expert opinion](#) on the permissibility of non-cumulative compounded SARON under Swiss law. The opinion seems to suggest that we're in the clear (in German).

Regulators

- **House Financial Services Committee:** The Subcommittee on Investor Protection, Entrepreneurship and Capital Markets held a [hearing](#) on LIBOR's end. Meeting materials included a [draft](#) of federal legislation to address legacy LIBOR exposures. The list of witnesses providing testimony included representatives from the [Fed](#), [US Department of the Treasury](#), [Securities and Exchange Commission](#), [Office of the Comptroller of the Currency](#) and [Federal Housing Finance Agency](#).
- **New York State:** Governor Cuomo signed into law [a bill](#) based on ARRC's proposed legislative solution to address legacy LIBOR exposures without robust or no fallback language. The ARRC promptly [welcomed](#) the enactment of the bill.
- **House of Lords (UK):** [Declined](#) to take forward proposed [amendments](#) to the UK's Financial Services Bill that would have provided a safe harbor from litigation for contracts referencing a prospective synthetic LIBOR. The UK Treasury is expected to continue work on addressing the issue.
- **Bank of Canada:** [Began](#) the publication of a CORRA index on April 6, 2021.
- **Reserve Bank of Australia:** [Addressed](#) the current state of the transition away from LIBOR in its latest financial stability review.
- **Bank of Thailand:** [Issued](#) a press release asking firms to accelerate the transition from THBFX to THOR. Banks are expected to end the use of THBFX in new transactions after July 1, 2021 (in Thai).

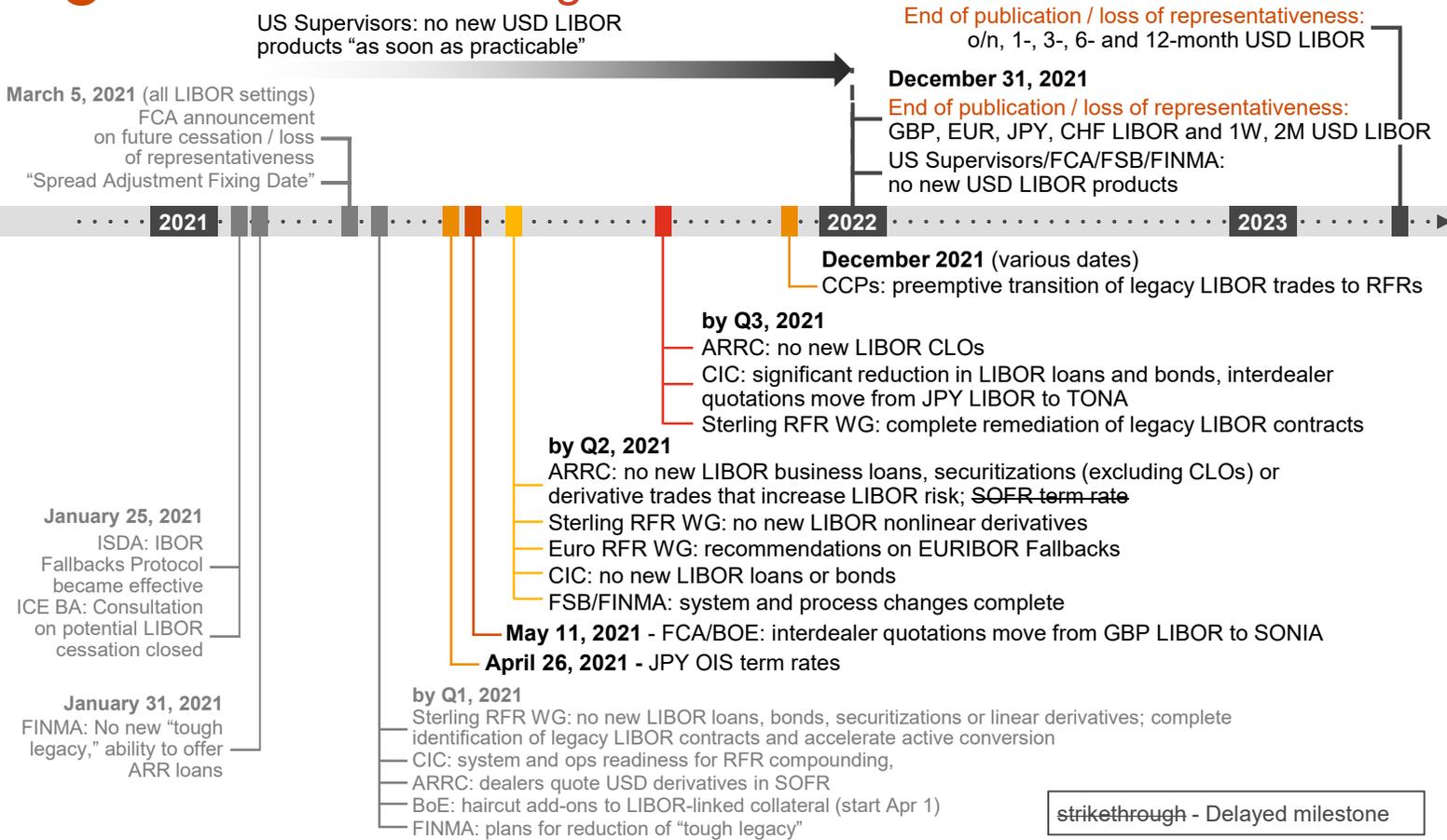
Industry groups, infrastructure providers and other items

- **ISDA:** Held the [Benchmark Strategies Forum](#), an event discussing the timetable for LIBOR's cessation, the transition of derivatives and discussions with prominent industry figures. In his [opening remarks](#) CEO Scott O'Malia reminded market participants that "Time is short, and firms should use it wisely." [Published](#) a [research note](#) summarizing the major developments in the transition to risk-free rates in 2021. The ISDA-Clarus RFR [adoption indicator](#) for March 2021 fell to 8.8%, compared to 10.6% in February.
- **LSTA:** Published a [market advisory](#) containing language that describes a fallback to a credit-sensitive rate, designed to be included as an optional step in hardwired fallback language in syndicated and bilateral business loans (member access only). Held a [panel discussion](#) focused on the operationalization of different conventions for the use of alternative reference rates. The LSTA summarized key takeaways in a [blog post](#), suggesting that markets will almost certainly find themselves in a multirate environment.
- **LMA:** [Published](#) an interview with the head of LIBOR transition at an asset manager, providing his perspective on sector-specific issues. (member access only)
- **SIFMA:** [Called](#) for federal legislation to address tough legacy USD LIBOR exposures, following ARRC's approach.
- **SIFMA (et al.):** Voiced their support of federal legislation to address "tough legacy" LIBOR based contracts in a [letter](#) to the House Financial Services Committee.
- **Bank Policy Institute:** [Suggested](#) that federal legislation is needed to address the risk of tough legacy USD LIBOR exposures.
- **ICMA:** The association's latest quarterly report includes an [update](#) on the transition to RFRs, providing commentary on the feasibility of consent solicitations, fallbacks for GBP LIBOR bonds and legislative developments.
- **LCH:** [Announced](#) a series of fallback and conversion fees for contracts based on GBP, CHF, JPY or EUR LIBOR, with the intent of encouraging proactive transition.
- **CME:** Published its [proposal](#) to preemptively convert cleared LIBOR-based swaps to market standard OIS trades prior to LIBOR's cessation. In alignment with other CCPs, the CME is planning to convert trades referencing CHF and JPY LIBOR on December 3, 2021, and trades referencing GBP LIBOR on December 17, 2021. Trades referencing USD LIBOR would be converted closer to its cessation date on June 30, 2021. Reported on record SOFR futures activity in Q1 as part of its latest [Rates Recap](#).
- **Association of Corporate Treasurers (ACT):** [Published](#) an in-depth [borrower's guide](#) to the LMA's recommended facility agreements for RFR based loans. In an earlier [blog post](#), the ACT suggested using the SONIA index for SONIA based loans. [Summarized](#) the recent announcements on future LIBOR cessation and the implications for corporates in a blog post.
- **ICE Benchmark Administration:** [Announced](#) that it had launched ICE SONIA Indexes to facilitate the transition away from LIBOR in the GBP lending markets.
- **Bloomberg:** [Announced](#) that an independent review confirmed that the BSBY adhered to IOSCO principles.
- **FTSE Russell:** [Discontinued](#) the production and publication of indicative term SONIA reference rates.
- **Global Association of Risk Professionals:** [Suggested](#) that a mix of benchmarks and conventions might complicate the transition from LIBOR in CLOs.

5 LIBOR transition target dates

US Supervisors: no new USD LIBOR products "as soon as practicable"

June 30, 2023



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