LIBOR Transition

Market update:
February 1-15, 2021

Register HERE

318 days to **December 31, 2021**
864 **June 30, 2023**

1 Highlights

WG on Sterling RFR consultation on bond market fallbacks recommendation

What happened? The WG on Sterling RFRs issued a consultation paper, seeking input on whether it should formally recommend a successor rate to GBP LIBOR in legacy bond contracts, and what that successor rate should be.

A formal recommendation would clarify the fallbacks for legacy bond contracts that, upon LIBOR's cessation, stipulate the selection of a replacement rate (and spread adjustment) in accordance with a formal recommendation by relevant industry body or customary market practice. In the absence of a formal recommendation, the issuer or their independent advisor would need to determine what constitutes customary market practice. Despite having generally recommended SONIA as the preferred alternative to GBP LIBOR, the working group suggests that issuers' determinations might face legal challenges.

The working group suggests it could make one of two different recommendations for a successor rate, effectively removing the need for issuers or their advisors to make their own determination:

(1) overnight SONIA compounded in arrears, or
(2) term SONIA

The working group has already made a recommendation for a spread adjustment that would be added to the replacement rate.

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The paper provides a series of considerations for the selection of either SONIA compounded in arrears or term SONIA as the successor rate. The choice of SONIA compounded in arrears would be consistent with conventions for the use of SONIA in a wide range of other products, as well as the working group and regulators' stated expectation that the majority of GBP markets will be based on SONIA compounded in arrears going forward. The working group concedes, however, that the choice of term SONIA as the successor rate might align more closely to the ARRC's recommendation of term SOFR as the preferred fallback in bonds referencing USD LIBOR. Finally, operational implementation of term SONIA as the successor rate would represent a smaller diversion from established legacy processes and system capabilities.

Comments are requested by March 16, 2021.

Our take: The formal recommendation of a successor rate contemplated by the working group would only apply to a specific subset of bond issuances containing the specific contractual fallback provisions described above. The consultation is not intended to provide recommendations for the remediation of business loans or issues of tough legacy exposures, i.e., bonds containing fallback language that makes it impractical, or in some cases outright impossible, to remediate them prior to LIBOR's cessation.

We would also caution market participants not to misinterpret the consideration of term SONIA as a possible successor rate recommendation as a change in tone or even endorsement of a broader use of term SONIA. That said, a recommendation of term SONIA would seemingly be at odds with the working group's expectation that term SONIA would only see limited use as a replacement to GBP LIBOR, a position echoed by UK regulators.

A formal recommendation would effectively stipulate the same spread-adjusted replacement rate for all legacy bond contracts containing fallback language that refers to the recommendation of a relevant nominating body. It's not clear that all issuers prefer that solution. Some might look to retain some flexibility in determining a successor rate, as the most appropriate replacement rate might differ depending on contract structures, underlying assets or cross border implications.

As it has often been the case in deciding on a path forward, market participants will have to weigh the costs and benefits. A formal recommendation would relieve issuers from having to make a determination and possibly seeing that determination challenged. On the other hand, whatever the recommended replacement might be, issuers would cede some control over the operational and economic implications of LIBOR cessation for affected contracts. The most obvious path to retaining full control over how — and when — contracts are transitioned to a replacement rate remains proactive remediation in advance of LIBOR's cessation, to the greatest extent possible.

Europe's legislative solution for legacy contracts

What happened? The European Union (EU) adopted the proposed amendments to the EU Benchmarks Regulation (BMR) that would allow the European Commission to designate a statutory replacement for LIBOR in legacy contracts upon LIBOR's cessation. Following the European Parliament's endorsement earlier this year, the European Council adopted the amendments earlier this month, thereby paving the way for their enactment.

The legislation functions similarly to legislation proposed in the US, in that its applicability is limited to contracts that have either no or inadequate fallback provisions to address the permanent cessation of LIBOR. The legislative proposal recently introduced in New York State would apply to any financial contract written under New York State law. The EU's legislation is somewhat broader in scope, as it not only applies to contracts subject to European law but also to any contract between two parties established in the EU. In fact, the scope of the amendments has widened extensively from an initial draft published in July 2020, which had been limited to specific financial instruments and contracts entered into by EU supervised entities.

The amendments also extend the transition period for the continued use of third-country benchmarks until December 31, 2023. That deadline could be further extended until December 31, 2025, in case the unavailability of a third-country benchmark poses a threat to financial stability. The extension had become necessary following the completion of Brexit, which resulted in LIBOR becoming a third-country benchmark under the EU BMR. The new deadline aligns the EU BMR with the extended transitional period introduced as part of the UK's Financial Services Bill, which is currently making its way through the UK Parliament.

Lastly, the amendments provide relief from EMIR clearing and margin requirements for legacy contracts amended for benchmark reform.

Our take: The first legislative solution for legacy LIBOR-exposures is now in place. The speed with which the proposal moved through the European

rule-making bodies was remarkable, highlighting the importance that the official sector placed on mitigating the risk associated with a potentially large number of contracts without a clear path to transition away from LIBOR.

The prospect of a statutory replacement addresses legal uncertainty in (some) legacy contracts with insufficient fallback language but does not represent a universal solution for all contracts. In the case of contracts entered by EU entities that are written under the laws of third-party jurisdictions, the EU's solution explicitly excludes contracts that are subject to legislative solutions in those jurisdictions. While this should reduce some of the conflict with legislative solutions under consideration in the UK and New York State, it also means that organizations will be required to navigate a complex landscape of contractual provisions, applicable governing law and the resulting impacts on their existing contracts.

Rather than relying on a legislative solution, firms should look to proactively remediate legacy LIBOR contracts to the greatest extent possible. Not only does that represent the easiest path to avoid the pitfalls and uncertainties of a legislative solution, but it also allows firms to retain control over the terms under which legacy contracts are transitioned.

Singapore: transition to SORA

What happened? The Steering Committee for SOR & SIBOR Transition to SORA (SC-STS) published an updated transition roadmap. The committee confirmed its guidance to end the issuance of new SOR-based loans by the end of April 2021, even as the likely continued publication of USD LIBOR into June of 2023 would allow for the continued publication of SOR as well. SOR depends on USD LIBOR as an input into its calculation.

The announcement followed a speech by Monetary Authority of Singapore (MAS) Deputy Managing Director (Markets & Development) Leong Sing Chiong, who declared that Singapore would press ahead to facilitate the transition from SOR to SORA, including the focus on building liquidity and price discovery in the SORA curve through extended clearinghouse-traded tenors. Chiong noted that the continued publication of SOR, as a result of the continued publication of USD LIBOR, would allow extra time for the run-off or remediation of existing exposures but continued to advocate for an active conversion of exposures. He suggested the time period between June 2021 and early 2022 could become a "sweet spot" for active conversion of existing SOR loans, given expectations for sufficient liquidity in both the SOR and SORA curves to allow price discovery.

The SC-STS guidance mirrors guidance issued by the US banking regulators, who clearly communicated their expectation that the use of USD LIBOR after the end of 2021 will be confined to legacy exposures.

Our take: SOR is one of a number of local Asian interest rates that rely on USD LIBOR as an input into their calculation. With this announcement, SC-STS has become the first regional working group to confirm it would follow the cessation dates proposed for USD LIBOR. The Bank of Thailand had previously indicated it may decide to extend the publication of THBFIX, one of the rates relying on USD LIBOR as an input, into mid-2023 as well.

The target date revisions should provide welcome relief for the industry, given that liquidity in SORA markets is still evolving. The extended publication of SOR reflects a practical common sense approach for existing contracts but should not be confused with relaxed expectations for the active transition away from SOR. Both the speech and SC-STS' roadmap make it clear that developing liquidity in SORA markets remains a priority. Firms should expect to be held to the deadline of April 2021 to stop writing new SOR loans.

OCC's self-assessment of transition preparedness

What happened? The Office of the Comptroller of the Currency (OCC) released a self-assessment tool for banks to evaluate their preparedness for LIBOR's cessation. The tool includes 30 "yes or no" questions on banks' transition planning, execution of transition plans, fallback language in new contracts, remediation strategy for legacy exposures, and oversight and reporting.

Our take: The questions included in the OCC's tool are generally consistent with previous regulatory guidance, such as the OCC's previous bulletins and the more recent interagency statement on LIBOR cessation. While the document contains few, if any, step-by-step pieces of transition guidance, banks should find it useful as a checklist against which to evaluate their own program — sooner, rather than later, that is. Albeit a bit unusual, the OCC's inclusion of an "expiration date" of July 2021 seems to serve as a reminder that there is only so much time left for firms to finish their preparations. Presumably, any market participant that finds itself still completing readiness assessments deep into the third quarter of 2021 will have quite a bit of catching up to do.

In its questionnaire, the OCC reminds banks that it "does not endorse a specific Libor replacement rate." Amid concerns about SOFR's appropriateness as a lending rate raised by a number of smaller institutions and the ensuing discussions as part of the FRB NY's credit sensitivity group, regulators have made it clear that firms wouldn't be criticized solely based on their choice of replacement rate for LIBOR. It is becoming clear, however, that the freedom of choice of a replacement comes with a number of caveats and responsibilities. While several credit-sensitive benchmarks are beginning to emerge, banks might be subject to regulatory scrutiny should they choose to employ such a rate without first performing appropriate due diligence on their suitability. The OCC's self-assessment suggests that banks' process to identify alternative reference rates should consider their suitability and ongoing availability, potential risks associated with underlying market liquidity, and potential compliance or reputation risks related to the fair treatment of customers.

The prevalence of considerations related to customer treatment, client outreach, communication and transparency suggests that conduct risk related to the transition away from LIBOR will be firmly entrenched in the regulatory agenda.

HMT consultation on safe harbors

What happened? The UK's HM Treasury (HMT) issued a consultation asking market participants for input on the appropriate scope of potential legal protections, or safe harbors, associate with the prospective publication and use of synthetic LIBOR.

HMT proposes a legal "safe harbor" to minimize litigation risk associated with legacy, GBP LIBOR-based contracts referencing such a synthetic rate, should the FCA mandate a change in LIBOR's calculation methodology to end its reliance on panel bank submissions.

The HMT's proposal comes in response to stakeholder concerns that parties to a contract might legally challenge the appropriateness of referencing a synthetic rate. Specifically, HMT is considering guidance to codify that a methodology change of a critical benchmark, i.e., GBP LIBOR, should not:

- discharge or excuse the performance of a contract;
- give the right to unilaterally terminate or suspend performance of a contract;
- create liability for a facility or calculation agent; or
- constitute a breach of, void, amend, modify or novate a contract.

Specifically, HMT is asking for input with respect to the rationale for providing such safe harbors, issues of scope, applicability, implications for contracts written under UK law entered into by firms outside of the UK and other considerations for how it could provide protection from potential litigation.

Our take: Late last year, the Fed's Vice Chair for Supervision, Randal Quarles, cautioned against a solution based on a synthetic LIBOR for legacy contracts in the US market, citing its different litigation framework. Judging from the HMT's consultation, there appears to be concern that lawyers on the other side of the pond might prove to be just as litigious as their American counterparts.

It should be clear by now that there aren't any perfect solutions for legacy LIBOR-based contracts, specifically those that cannot reasonably be remediated prior to LIBOR's cessation — i.e. "tough legacy" exposures. Not only are there questions about the scope and potential limitations of a synthetic LIBOR, any potential safe harbor would come with additional uncertainty surrounding the type of contracts that may be covered. Lending contracts often contain nonstandard, bespoke or otherwise complex provisions. It seems rather difficult to guarantee that any safe harbor could account for all eventualities. Just as in the case of the EU's recently passed legislative solution for legacy contracts, a proactive transition of as many exposures as possible should remain the focus for most, if not all, market participants.

For more information please read our latest publication: HMT proposes a safe harbour for certain LIBOR-referencing contracts.

Join the conversation

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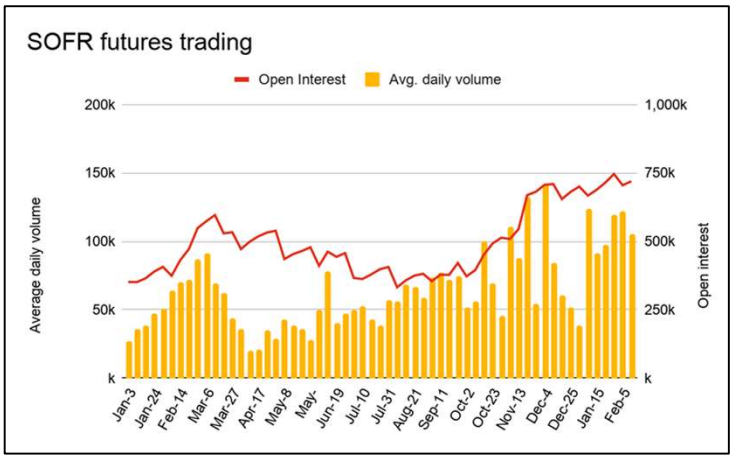
The Move Away from LIBOR: Bringing non-LIBOR loans to market within the next 300 days

Webcast | February 23, 1:00PM ET

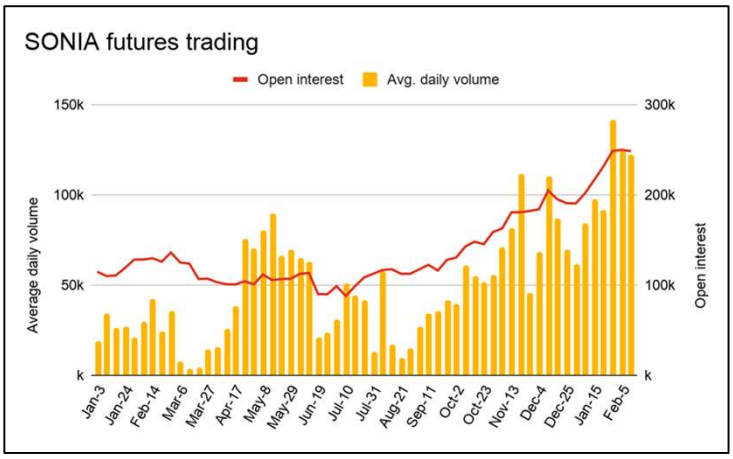
Register HERE

2 RFR adoption: Derivatives

Futures and options



Source: CME, ICE (accessed February 15, 2021)



Source: CME, LCH, ICE (accessed February 15, 2021)

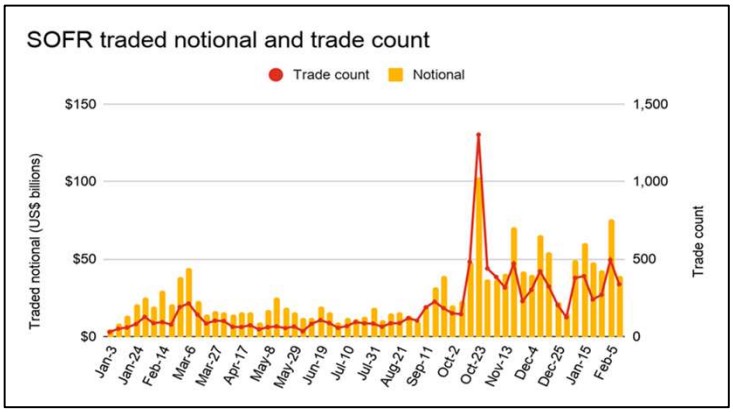
Our take: Over the first two trading weeks of February, trading in SOFR futures has continued at levels similar to those observed since the beginning of the year. Open interest and the average daily volume of traded SONIA futures remained at an all-time high, just barely receding from the record setting levels seen in late January.

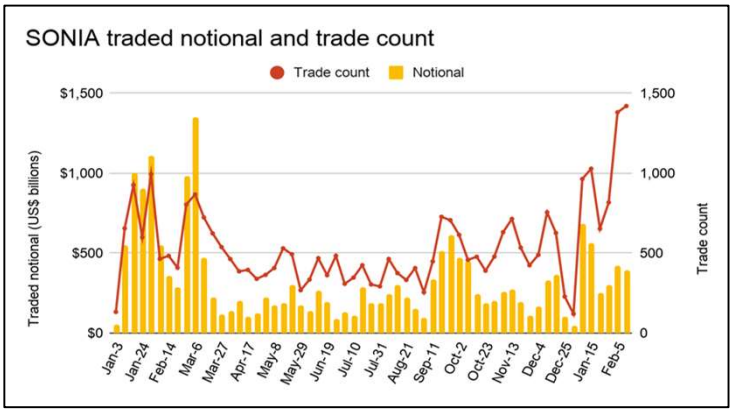
ISDA IBOR Fallbacks Protocol adherence
(as of February 15, 2021)

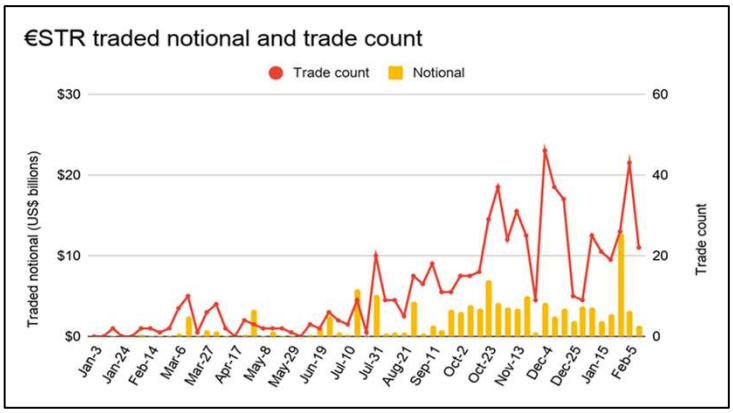
- 13,321 total entities (up from 13,081)
- 29 out of 30 G-SIBs (unchanged)

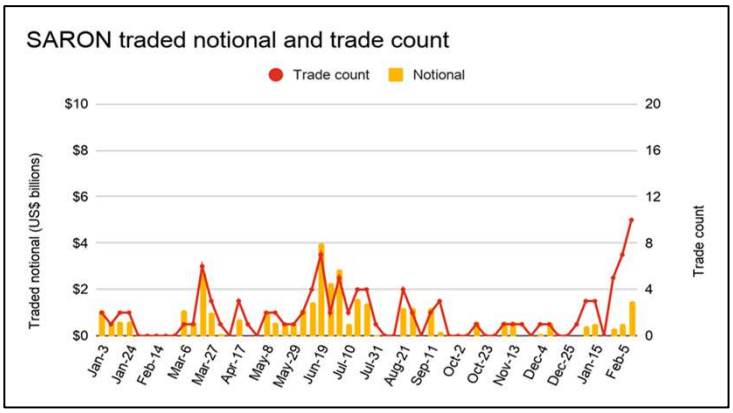
Source: ISDA

Swaps trading





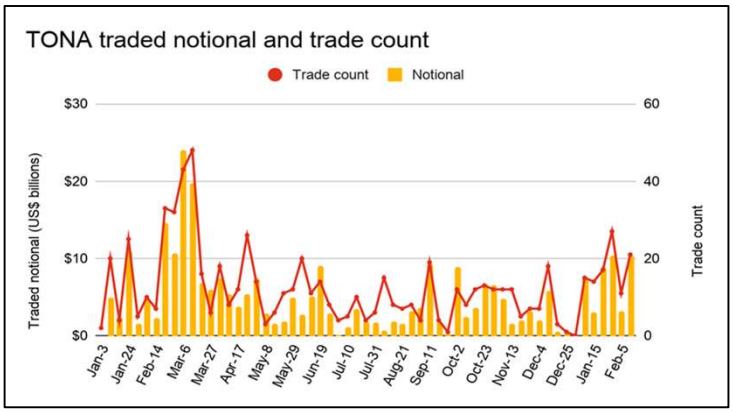


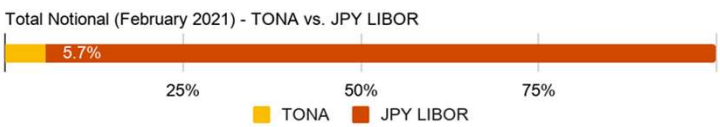


Our take

Notional and trade counts in SOFR swaps increased in the first week of February but haven't been able to show sustained upward momentum since the PAI and discounting switch in October 2020. While there isn't any official guidance on the level of SOFR derivatives trading that would be required to derive a robust SOFR term rate, it does appear that the ARRC's target date of 2H 2021 for the availability of such a term rate should not be considered a certainty.

Trade counts in SONIA and SARON swaps have seen a sharp uptick in recent weeks — and we expect notionals to follow that trend in coming weeks. But while the uptick in volumes is encouraging, it has yet to come at the expense of trading in LIBOR derivatives. The SONIA portion of overall GBP Sterling swaps trading fell to just over 40% in the month of February, its lowest level since June of last year.





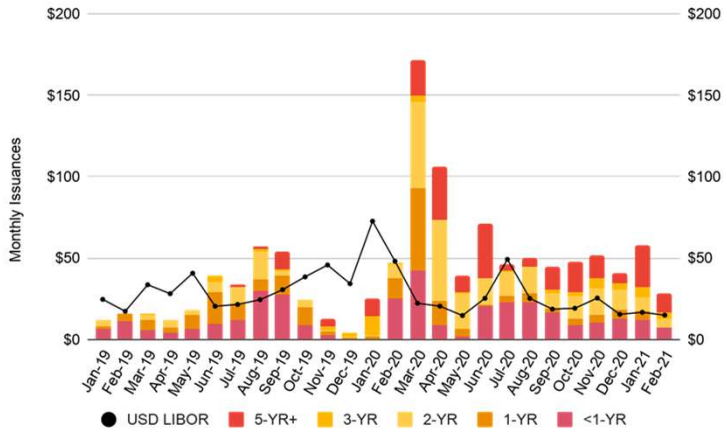
Source: analysis.swapsinfo.org (Interest rate and credit derivatives weekly trading volume): Week ending February 12, 2021, accessed February 16, 2021.

3 RFR adoption: Cash products

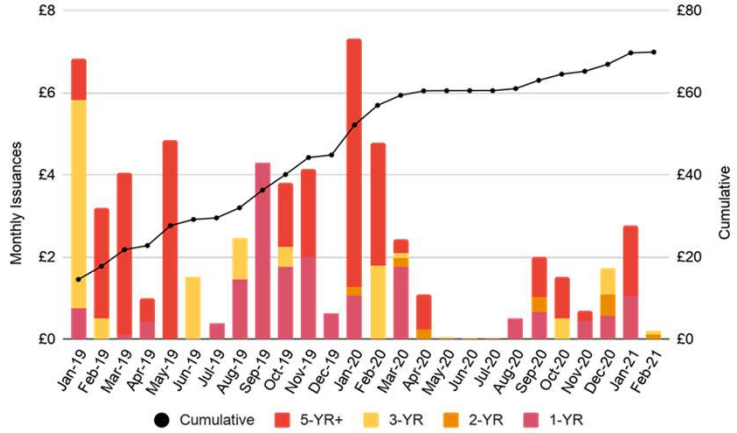
FRN issuances *(as of February 15, 2021)*

Source: Bloomberg

USD FRN issuances (in billions)



SONIA FRN issuances (in billions)



Our take

It appears that the market has taken it upon itself to adjust the ARRC's December 31, 2020, target date for an end of new USD FRN issuances tied to LIBOR. Just over $30 billion in FRNs tied to USD LIBOR have been issued since that date has come and gone. However, the vast majority of these issuances have maturity dates before June 2023, the presumed end date for the publication of USD LIBOR. While we are still awaiting the results of IBA's consultation on the continued publication of USD LIBOR, it appears that market participants are firmly counting on its continued availability.

Notable cash product issuances and other RFR adoption[1]

RFR	Company	Detail	Resources
SOFR	Sberbank	Began offering SOFR and €STR based loans to its commercial customers, targeting expansion to all RFRs in Q1 2021.	Press Release
	World Bank: IBRD	Priced a new $600 million, 10-year bond linked to the SOFR index, the longest dated RFR-based floating rate note to date.	Press Release
	World Bank: IFC	Issued a AUD $155 million bond swapped from fixed rate to SOFR, considered the first of its kind in what is known as the Kangaroo bond market.	Press Coverage
	VTB	The Russian bank Issued its first SOFR-linked USD-denominated bonds.	Press Coverage
SONIA	ICG	Included a rate switch feature on a new £500 million revolving credit facility. The facility can be drawn on in either USD or GBP LIBOR and includes switch features to SONIA and SOFR.	Press Coverage
	Blackstone	Issued a £323 million SONIA-linked UK CMBS backed by 45 UK logistics properties.	Press Coverage
CORRA	Royal Bank of Canada	Issued its first floating rate note referencing CORRA compounded in arrears - a $500 million 1-year note.	Press Release

For additional details on employed conventions and other parameters of recent RFR-based loans, see the Loan Market Association's (LMA) 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)

- Published minutes from its January 13 meeting.

WG on Sterling RFRs:

- Published a potential methodology to replace the GBP LIBOR ICE Swap Rate with SONIA-based rates to support the transition of non-linear derivatives.
- Published a consultation asking for market participants' input on whether the WG should make a recommendation for SONIA as successor rate to GBP LIBOR in bonds. The WG is considering recommending either SONIA compounded in arrears or Term SONIA.
- Published its January newsletter.

WG on Euro RFRs:

- Published summaries of responses to its consultations on EURIBOR fallback trigger events and €STR-based EURIBOR fallback rates.

CIC on JPY IR Benchmarks:

- In its response to the FCA's consultation on exercise of its new powers, the committee suggests that publication of a synthetic JPY LIBOR after the end of 2021 would help the orderly wind down of legacy contracts.

NWG on CHF Reference Rates:

- Published an executive summary of the working group's February 1 meeting.
- Released a template for a rate switch amendment for syndicated loans, based on a lookback with observation shift (and lag as alternative), compounded SARON and an optional floor for compounded SARON.

Steering Committee for SOR & SIBOR Transition to SORA

- Published an updated transition roadmap, confirming its guidance to end the issuance of new SOR-based loans by the end of April 2021 and measures to spur further growth in SORA markets.

Regulators

- **UK HM Treasury:** Issued a consultation asking market participants on the appropriate scope of potential legal protections or safe havens for users of a synthetic LIBOR rate.
- **European Union:** Adopted the proposed amendments to the EU Benchmarks Regulation (BMR) that would allow the European Commission to designate a statutory replacement for LIBOR in legacy contracts upon LIBOR's cessation.
- **OCC:** Released a self-assessment tool for banks to evaluate their preparedness for LIBOR's cessation.
- **FRB NY:** Published the minutes and presentation materials from the final workshop on credit-sensitive benchmark rates.
- **CFTC:** The CFTC's Market Risk Advisory Committee (MRAC) will meet on February 23.
- **US Dept of Treasury:** In its report to the secretary, the department's Treasury Borrowing Advisory Committee (TBAC) noted that its members unanimously supported the announcement, and eventual issuance, of a SOFR FRN.
- **Monetary Authority of Singapore:** In a speech, the MAS' Deputy Managing Director (Markets & Development) Leong Sing Chiong declared that Singapore would press ahead to facilitate the transition from SOR to SORA.
- **Bank of Uganda:** The bank's deputy governor urged financial institutions to build awareness and prepare for the LIBOR's cessation.
- **UK Infrastructure and Projects Authority:** Issued a guidance document on LIBOR cessation and its impact on PFI projects.

Industry groups, infrastructure providers and other items

- **UK Finance (w/ PwC):** Published a guide for banks on lenders on the discontinuation of LIBOR, including a checklist and operational and commercial considerations.
- **EMMI:** Confirmed January 3, 2022, as the planned cessation date for EONIA, urging market participants to phase out the benchmark prior to its cessation.
  Published the results of the first annual review of EURIBOR's hybrid methodology, which resulted in a number of small adjustments to the methodology that will be implemented in April of this year.
- **ISDA:** The latest issue of ISDA Quarterly reflects on fallbacks taking effect but also reminds market participants that fallbacks were never intended to be a primary means of transition legacy LIBOR-based positions.
  The ISDA-Clarus RFR Adoption Indicator for January 2021 remained at 10.0%, unchanged from the previous month.
- **LSTA:** Published a draft of an updated template for multicurrency, investment-grade term loan and revolver agreements, which incorporate ARRC's hardwired fallback language (member access only).
- **LMA:** Published a set of notes and considerations on its various LIBOR transition related drafts and documents, specifically with a view on jurisdictions other than the UK and other loan product areas (member access only).
  Its latest webinar update on the transition from LIBOR in the loan market is now available on demand.
- **ICMA:** Published a briefing on the transition from LIBOR in the bond markets, addressing RFR adoption, active transition of legacy bonds, legislative solutions and the transition in APAC. The briefing is also available as a podcast.
- **CFA Society of Chicago:** Published a summary of a recent panel on LIBOR cessation. A key point of discussion were credit-sensitive benchmark alternatives to SOFR.
- **The Investment Association:** The UK organization wrote to bond issuers, calling for an active transition of legacy LIBOR-based contracts as quickly as possible.
- **GFOA:** Issued a reference sheet outlining common sources of LIBOR exposure and suggested actions to address them.
- **CME:** Announced amendments to its rulebook to include SOFR-based fallbacks in 3M Eurodollar Futures and options.
- **EUREX:** Published a summary of a virtual roundtable on the transition from Swiss LIBOR to SARON.
- **Bloomberg ISL:** Responded to the WG on Sterling RFR's letter on the availability of fallback spread adjustments to the cash markets,
- **International Islamic Financial Market:** Announced it would publish unified guidelines on Shari'ah solutions for issues related to LIBOR transition in islamic finance.

5 LIBOR transition target dates

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

June 30, 2023
End of publication:
o/n, 1, 3, 6 and 12 months USD LIBOR

in Q1, 2021
FCA/IBA: announcements on cessation timing for all LIBOR settings
"Spread Adjustment Fixing Date" for all LIBOR settings

December 31, 2021
End of publication:
GBP, EUR, JPY, CHF LIBOR and 1W, 2M USD LIBOR
US Supervisors/FCA/FSB/FINMA: no new USD LIBOR products

2021 · 2022 · 2023

by December 31, 2020
ARRC: no new USD LIBOR FRNs, vendor readiness (securitizations), amend interdealer CSAs to use & make markets in SOFR IR products
GSEs stop purchasing LIBOR ARMs
FSB: ability to offer non-LIBOR loans

January 25, 2021
ISDA: IBOR Fallbacks Protocol becomes effective
ICE BA: Consultation on potential LIBOR cessation closes

January 31, 2021
FINMA: No new "tough legacy," ability to offer ARR loans

Note: Several milestones pending outcome of market consultations

by Q1, 2021
Sterling RFR WG: no new LIBOR loans, bonds, securitizations or linear derivatives; complete identification of legacy LIBOR contracts and accelerate active conversion
Euro RFR WG: recommendations on EURIBOR Fallbacks
CIC: system and ops readiness for RFR compounding
ARRC: dealers quote USD derivatives in SOFR
BoE: haircut add-ons to LIBOR-linked collateral (start Apr 1)
FINMA: plans for reduction of "tough legacy"

by Q2, 2021
ARRC: no new LIBOR business loans, securitizations (excluding CLOs) or derivative trades that increase LIBOR risk; SOFR term rate
Sterling RFR WG: no new LIBOR non-linear derivatives
CIC: no new LIBOR loans or bonds
FSB/FINMA: system and process changes complete

by Q3, 2021
ARRC: no new LIBOR CLOs
CIC: significant reduction in LIBOR loans & bonds; JPY OIS term rates
Sterling RFR WG: complete remediation of legacy LIBOR contracts

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