



LIBOR Transition

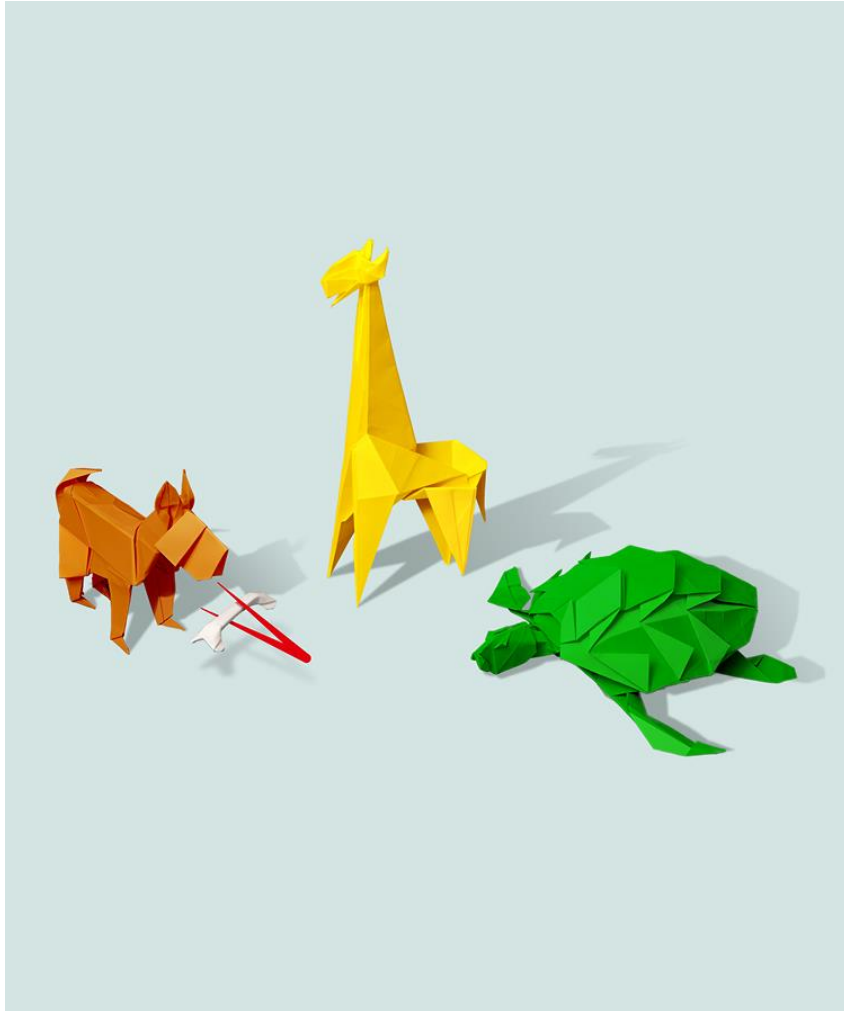
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IBOR Reform

February 2020








What we'll cover today

The expected discontinuation of LIBOR at the end of 2021 has a wide ranging impact on all financial services firms with exposure to LIBOR; strategically, operationally and financially

- ✓ Understand what is LIBOR and why it is being replaced
- ✓ Understand what the Alternative Risk Free Rates ("ARFRs") replacing LIBOR are and how they differ
- ✓ What are the risks and challenges of transitioning away for IBORs
- ✓ Deep dive into the what firms are doing to respond to the risks and challenges of moving away from LIBOR
- ✓ What firms priorities should be and what first actions should be

LIBOR: What is it?

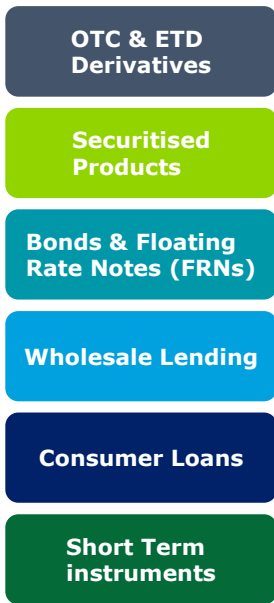
Overview & Key Facts

-  The **London Interbank Offered Rate** is the **average interbank interest rate** at which panel banks on the **London money market** are **prepared to lend to one another**
-  It is calculated by the ICE Benchmark Administration Ltd ("IBA") & published on **each working day** at 11.55am GMT by Refinitiv
-  Contributing banks are asked 'At what rate could you **BORROW** funds were you to do so by asking for & then accepting **INTER-BANK OFFERS** in a reasonable market size **just prior to 11am?**'
-  It is produced for five currencies (**GBP, USD, EUR, CHF, JPY**) & seven tenors (**overnight/ spot next, 1 week, 1 month, 2 months, 3 months, 6 months & 12 months**)
-  It is the rate of interest on a **fixed term maturity, set now & paid at the end of the term**
-  Between 11 & 16 panel banks for each currency submit their rates **based on transactions, transaction derived data & expert judgement**
-  The published rate is the **trimmed mean** of the individual submissions

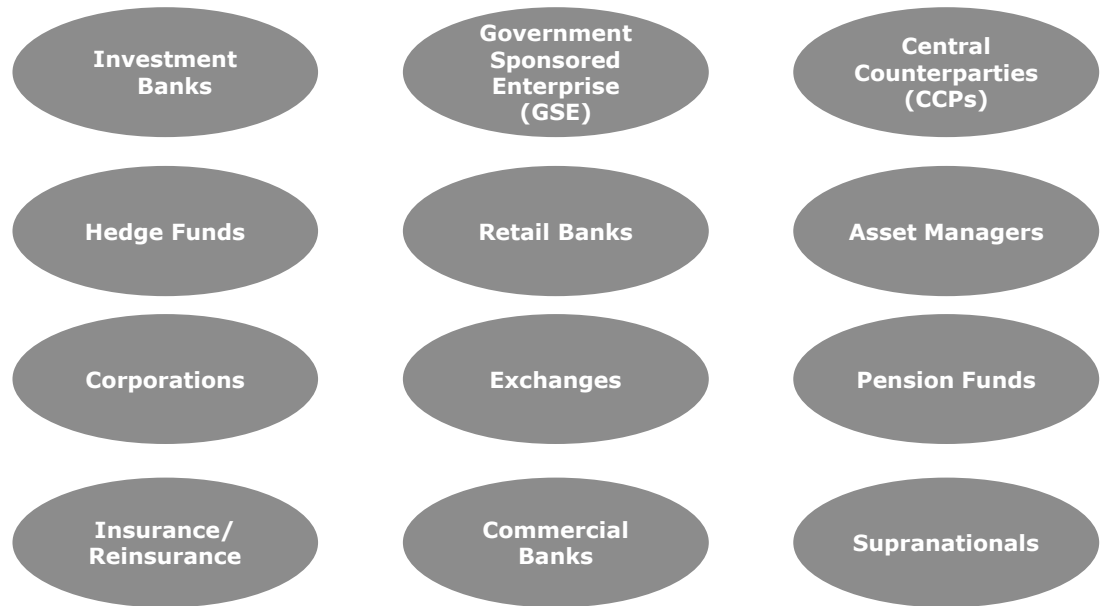
Financial Products & Users

LIBOR is widely used in a broad range of global financial products & contracts estimated to be worth \$350 trillion (~4 x Global GDP) on a gross notional basis

Product Types



Market Participants



Firms use LIBOR in a variety of ways, including indirectly where it could be used as part of valuations (including instrument and firm)

1. Discontinuation of IBOR

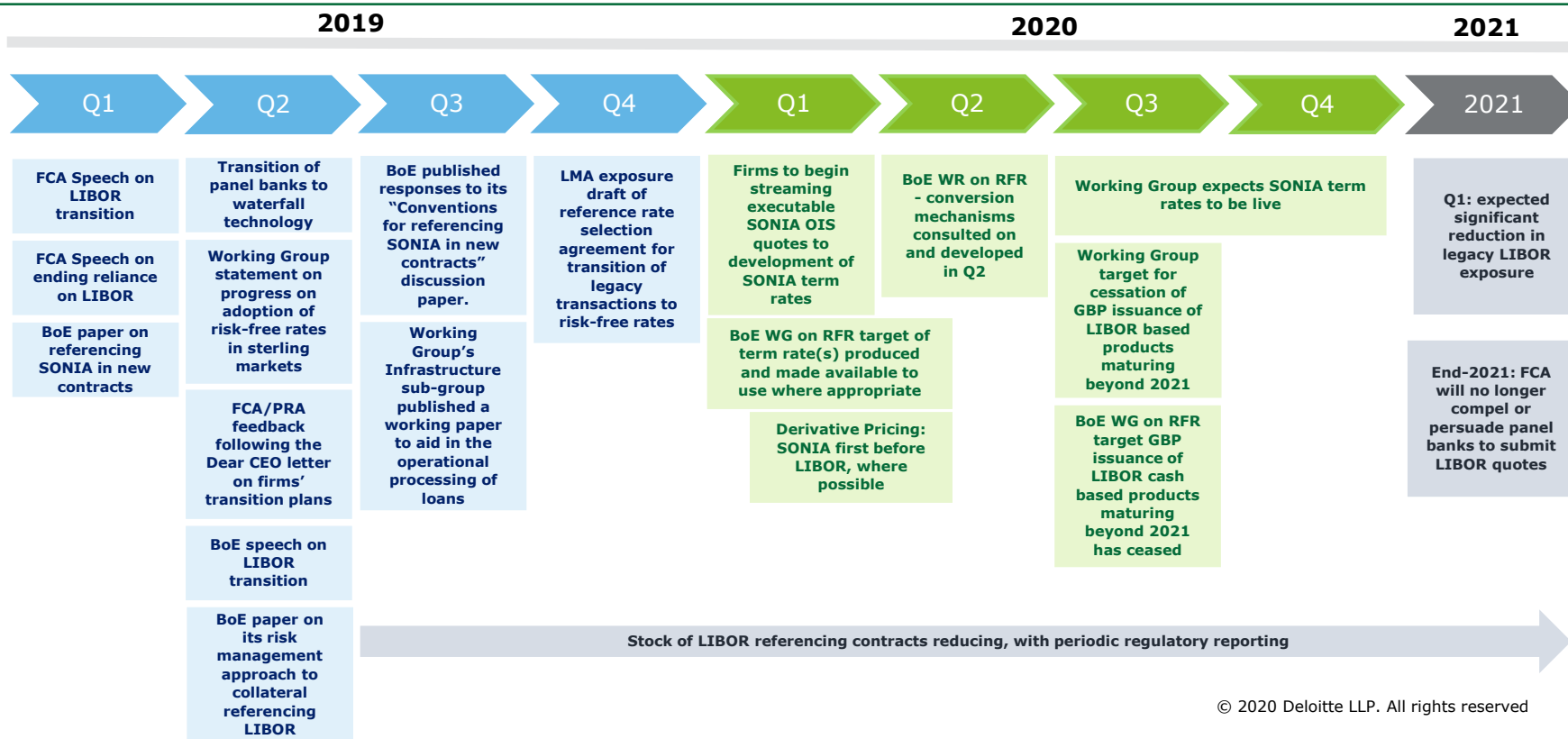
From 2014, the reform of major interest rate benchmarks has been on the global agenda

"Since the financial crisis, Libor really has become the rate at which banks don't lend to each other." Mark Carney, Governor, Bank of England, May 2018

Background








In July 2017, the UK Financial Conduct Authority (FCA) announced a transition away from the London Interbank Offered Rate (LIBOR) as the key interest rate index used in calculating floating or adjustable rates for loans, bonds, derivatives and other financial contracts. The FCA's intention is that, at the end of 2021, it would no longer be necessary to persuade, or compel, banks to submit to LIBOR.



Alternatives to LIBOR

Alternative Risk Free Rates (ARFRs) have been proposed by industry working groups in each corresponding LIBOR jurisdiction.

Region	Rate	Administrator	Type	Live	Description
	Sterling Overnight Index Average (SONIA)	Bank of England (BoE)	Unsecured	✓	<ul style="list-style-type: none"> ❖ Existing market for SONIA-linked swaps with supporting infrastructure ❖ Based on ~£40 bn daily transactions ❖ Transactions incl. bilateral & broker arranged overnight unsecured transactions ❖ Volume-weighted trimmed mean
	Secured Overnight Financing Rate (SOFR)	Federal Reserve Bank of New York	Secured	✓	<ul style="list-style-type: none"> ❖ Fully transaction based & robust underlying market ❖ Based on \$700 bn daily overnight repo transactions (1000> 3 month \$LIBOR) ❖ Close correlation with other money market rates
	Euro Short-Term Rate (€STR)	European Central Bank (ECB)	Unsecured	✓	<ul style="list-style-type: none"> ❖ Overnight unsecured fixed rate deposit transactions over €1m ❖ Calculated for each TARGET2 day as a volume-weighted trimmed mean to 3 dp ❖ ECB began publishing on 2 October 2019
	Swiss Average Rate Overnight (SARON)	SIX Swiss Exchange	Secured	✓	<ul style="list-style-type: none"> ❖ Secured rate reflecting interest paid on interbank overnight repo ❖ Most liquid segment of CHF money market ❖ Based on actual transactions & binding quotes ❖ IOSCO Compliant
	Tokyo Overnight Average Rate (TONA)	Bank of Japan (BoJ)	Unsecured	✓	<ul style="list-style-type: none"> ❖ Fully transaction based for uncollateralized overnight call rate market ❖ BoJ calculates & publishes daily using data from money market brokers ❖ High volume & diversity of participants with limited credit risk component

LIBOR vs Alternative RFRs

The characteristics of the new ARFRs are qualitatively & quantitatively different from LIBOR & will pose challenges for the transition

LIBOR

Calculation Methodology

- ✓ Forward looking estimate based on c.12 submissions

Publication

- ✓ 11am London time

Term Structure

- ✓ 7 rates from overnight to 12 months

Credit Premium

- ✓ Includes credit risk of unsecured interbank borrowing

Volumes

- ✓ Based on narrow range of contributor banks & diminishing interbank lending market

Consistency/ Timing

- ✓ Quoted on the same basis & time for all 5 currencies

Administrator

- ✓ Private Sector

ARFRs

- ✓ Backward looking trimmed mean based on transactions

- ✓ Different times for each currency

- ✓ Overnight rates that provide a purer read on a bank's cost of funding & will track a Central Bank's policy rate more closely

- ✓ Intended to act as a closer proxy to risk free as they have no bank credit or term premium embedded

- ✓ Based on robust, very liquid underlying markets & reflect large volumes of actual transactions

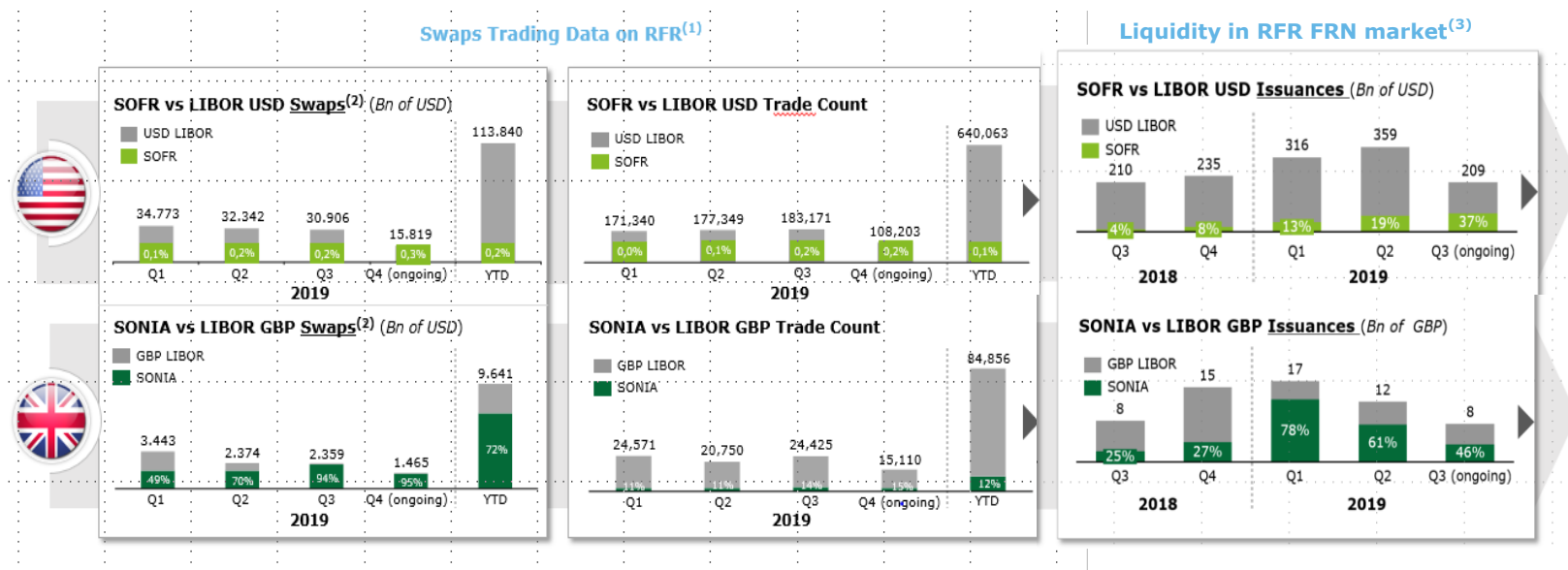
- ✓ Different methodology & publication timelines for each currency

- ✓ Central Banks for the majority of regions

4. LIBOR Transition

SONIA and SOFR market liquidity

Swaps Trading Data on RFR⁽¹⁾



Corporate Activity

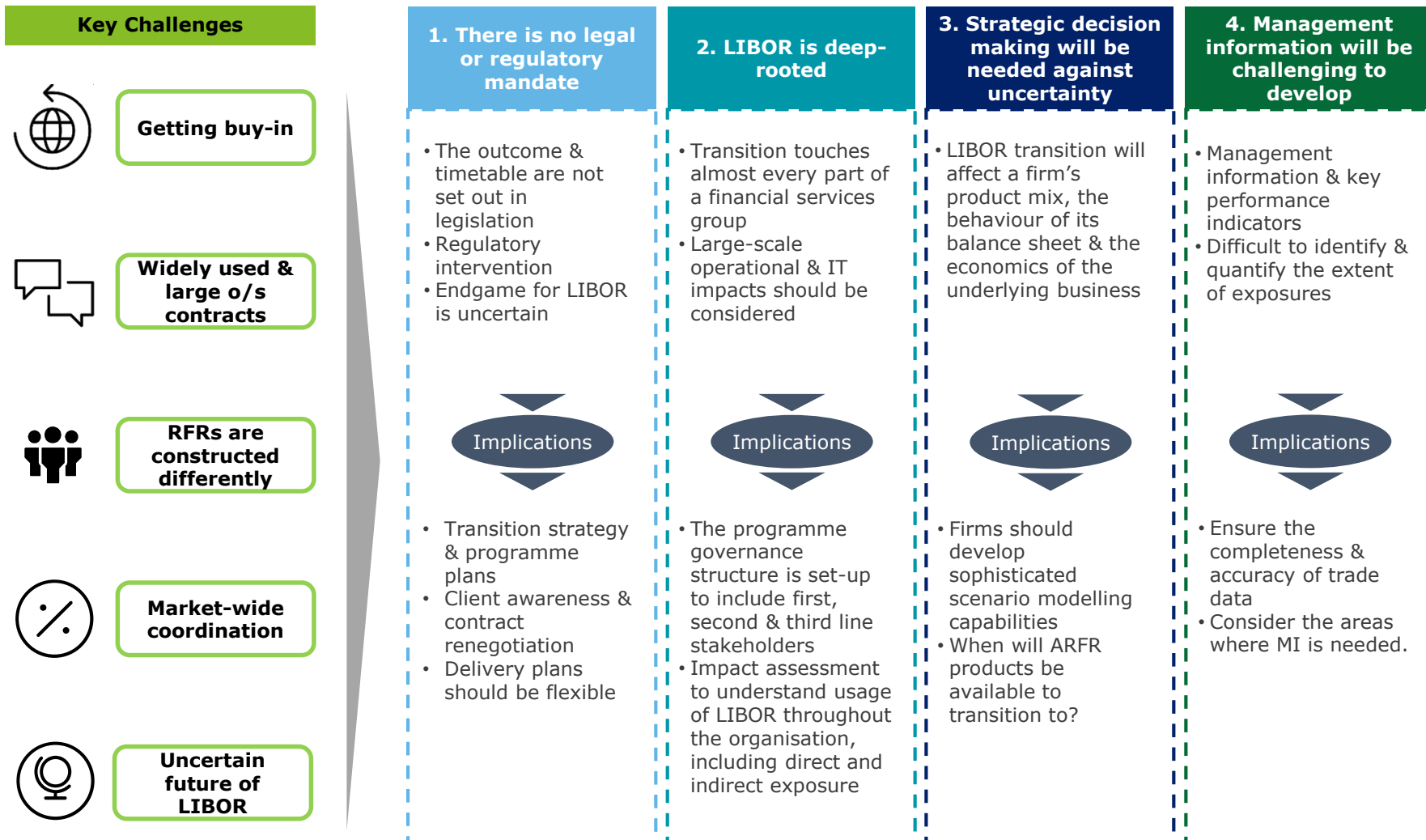
Entity	Product	Benchmark	Counterparty	Date	Comment
Associated British Ports	Floating Rate Bond	SONIA	NatWest	May-19	Transitioned existing
National Express	RCF	SONIA	NatWest	Jul-19	First loan
BMW	Floating Rate Note	SONIA	HSBC	Aug-19	First note issuer

Note: Data as of 29 November 2019

(1) Source: ISDA; (2) Nominal outstanding of swaps cleared through CCPs;

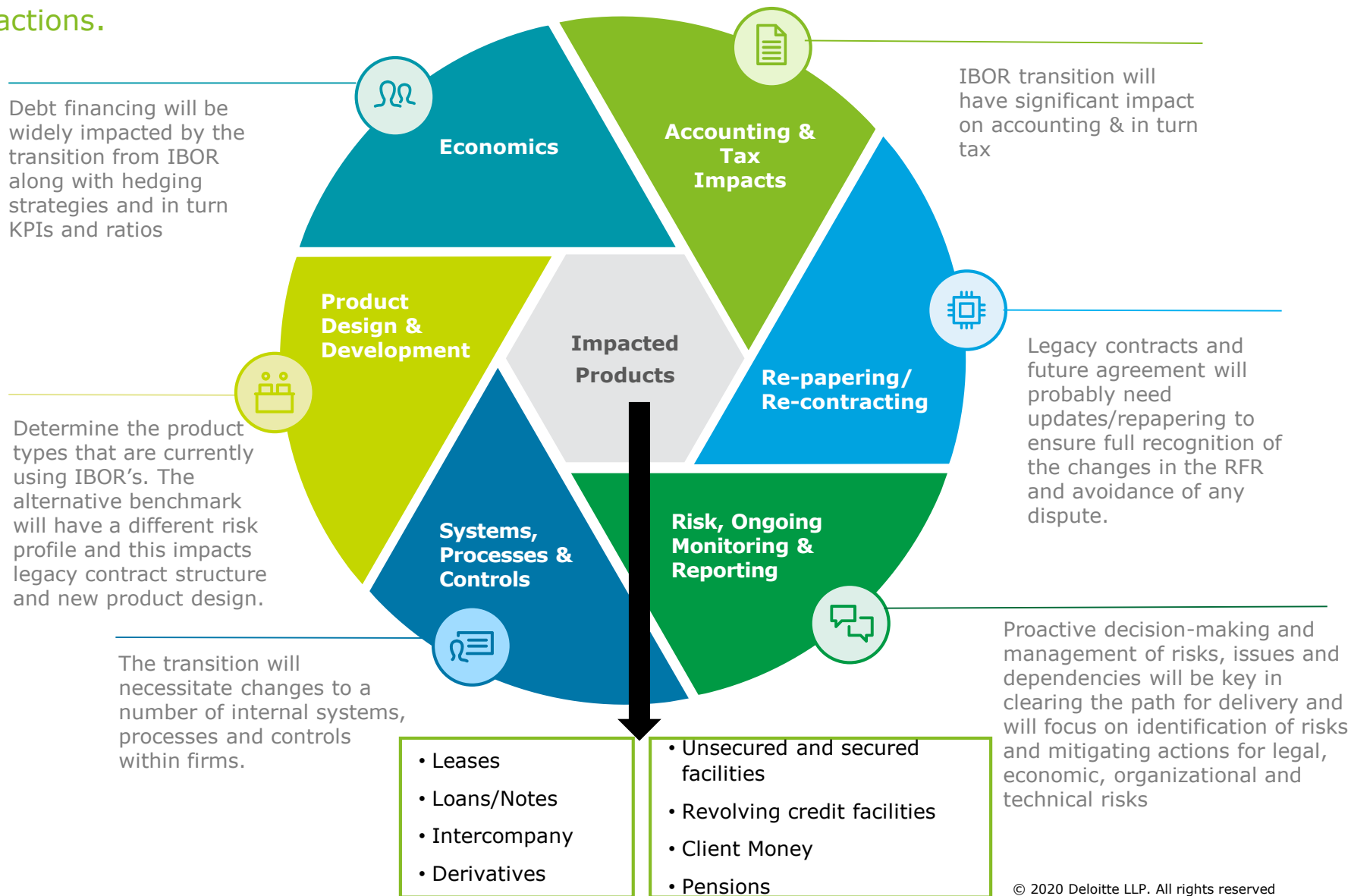
Key Challenges

LIBOR Transition brings a number of significant challenges for firms, at a time when existing regulatory and macro challenges are already significant.



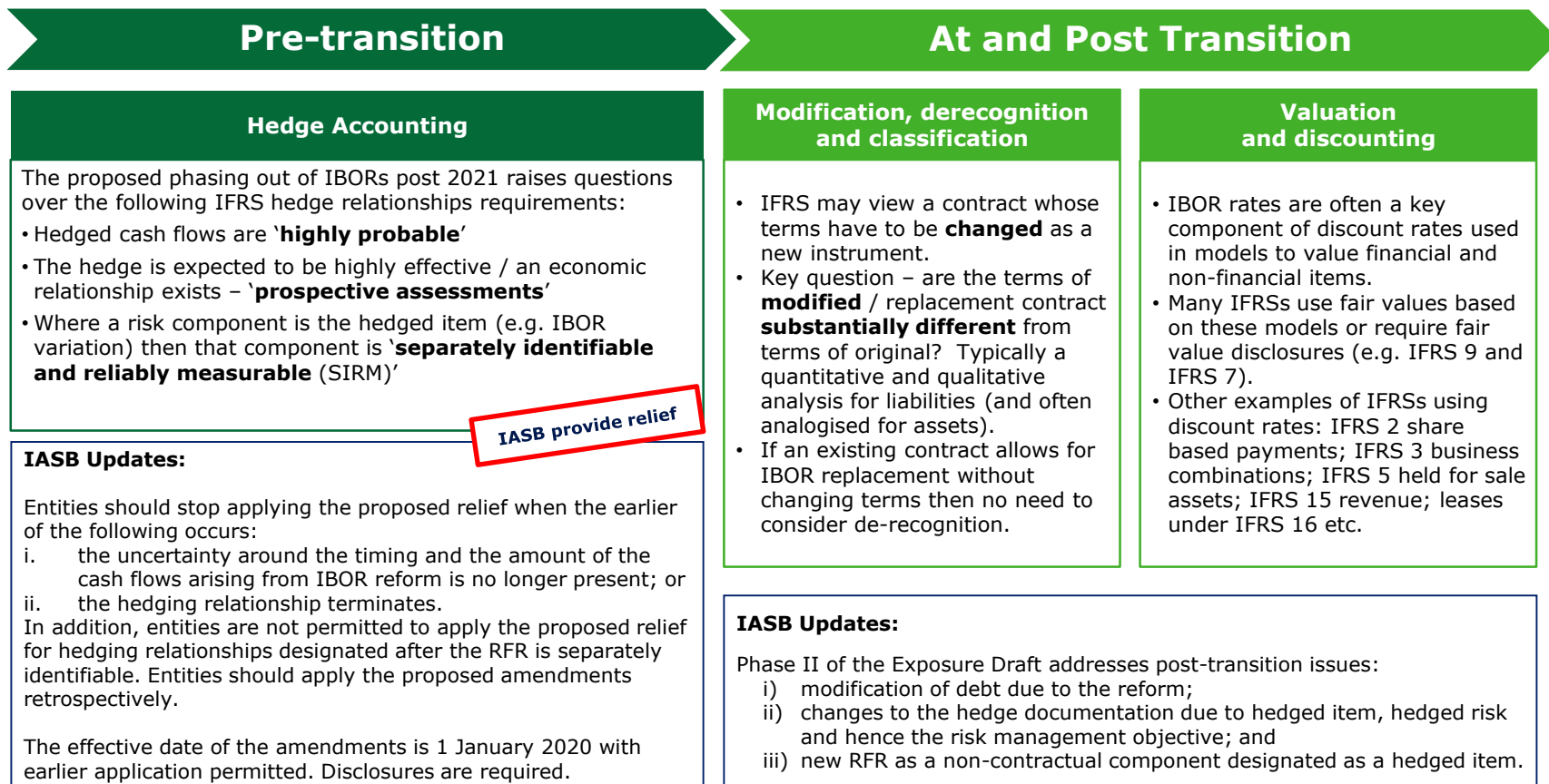
IBOR Transition Impacts

The impact of IBOR transition is significant for firms. Impacts are broad, wide ranging, and complex. Firms should be in a position to assess and quantify those impacts, and mitigating actions.



6. Accounting Considerations

In addition to the wide-ranging business impact, transition away from IBORs is set to have a significant impact the accounting treatment for products such as debt and derivatives, primarily hedge accounting of interest rate cash flows and instrument valuation techniques. A change in benchmark will almost certainly generate fair value adjustments and consequently a fair value gain or loss.



IASB provide relief

IASB Timeline Considerations



What firms are doing, and what are the priorities

Client Priorities

Challenges



Achieve senior level understanding, support and sponsorship

- Convincing stakeholders of the scale and complexity of IBOR Reform, and the need to understand the impacts now



Shape and mobilise their delivery programme

- Engaging the right people across business divisions and geographies
- Defining the role of the central / core programme team – 'thick' vs 'thin'



Complete the impact analysis

- Establishing the scenarios and assumptions
- Defining the scope, methodology, tooling and technology
- Gathering and analysing the inputs and data needed to complete the assessment
- Updating the impact analysis periodically



Stop the problem getting worse

- Updating fallback provisions for new trades / contracts
- Agreeing the timing of switching to products linked to Alternative Risk Free Rates (ARFR)



Engage externally, monitor industry developments and the response of clients and competitors

- Lack of buy-side intent to move away from LIBOR
- Educating and managing customers
- Understanding how the market is responding to conduct and competition issues



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Any questions?

Upcoming ICAEW Financial Services webinars and events

Webinars

25 March 2020, 15:30 – 16:30, IFRS 17 update

26 March 2020, 10:30 – 11:00, Stress Testing

28 April 2020, 14:30 – 15:30, FRC and the Stewardship Code

Other Events

22 May 2020, ICAEW Financial Services Climate Change Conference

Take a look at our current 2020 schedule at [icaew.com/fsfevents](https://www.icaew.com/fsfevents) or email us at fsf@icaew.com for more information

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