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Newsletter IBOR Reform 01/2022

Compilation by the Helaba IBOR Task Force

Last Update 14 January 2022

Foreword by Helaba IBOR Task Force

Ladies and Gentlemen,

Welcome to our first newsletter after the historic milestone of 31 December 2021 - the date on which EONIA and GBP, CHF, JPY and EUR LIBOR reference rates were permanently discontinued. We hope you and your families had a wonderful festive season and have started the New Year well and healthy. On behalf of Helaba, we would like to thank you very much for your cooperation in the transition to the new benchmarks and wish you all the best for the upcoming challenges this year.

In our first newsletter in 2022, we would like to review with you the latest developments of the IBOR reform in the fourth quarter of 2021 and shed light on what is still to come for market participants until mid-2023.

After intensive and partly very complex transition actions of contracts and systems, the market has now - at least for new business - fully arrived in the new world of risk-free overnight rates (so-called RFRs). All new business, also in USD, has to be concluded directly on the new reference rates €STR, SONIA, SARON, TONA(R) and SOFR. For legacy business that could not yet be converted, special legal regulations apply, which we will discuss in this newsletter. USD legacy contracts can still use USD LIBOR for the most commonly-used tenors until 30 June 2023 at the latest. However, as exposures to USD LIBOR exceed those across the combined four currencies that have ceased publication of traditional LIBOR a lot of transition work still needs to be done.

In our last newsletter dd. 14 October 2021 we reported in detail on the numerous developments in the most important currency regions affected by the IBOR reform. In this newsletter we have again compiled the most important developments for you and would like to share our market observations with you. Our compilations do not claim to be complete.

We hope that with our publications we have been able to support you and your companies well in the transition to the new benchmarks. Many thanks for the plenty of interesting and valuable discussions on IBOR transition we had with many of you. Going forward, we are still very much at your disposal for a personal exchange, for new business structuring on an RFR basis as well as the transitioning of USD LIBOR in existing contracts.

In case of any questions please do not hesitate to contact either your relationship manager or send an e-mail to us at ibor-reform@helaba.com.

Highlights and Market Observations since 14 October 2021 (1/7)

- Q4/2021 saw a huge conversion of loan agreements to comply with IBOR transition requirements before cessation date 31 December 2021 for EONIA and GBP/CHF/JPY/EUR LIBOR.

- Regarding the transitioning of multi-currency facilities including USD LIBOR we observed different approaches:
  - Part of the corporates decided on transitioning all relevant IBOR rates in one go, thereby transitioning USD LIBOR to SOFR Compounded at a later date via rate switch mechanism. That way all the transition work is done, but still leaves room up to the rate switch date to flexibly take into account any market developments by adjusting the contract. Should the Term SOFR not gain market relevance in Europe for multi-currency facilities, these clients are already settled without facing further legal costs for additional contract amendments.
  - A large number of corporates opted for transitioning all relevant IBOR rates, but excluded transitioning of the USD LIBOR. In these cases the interest periods were amended to exclude drawings in 1W/2M USD LIBOR as these less commonly-used tenors were terminated on 31 December 2021.
  - As the remaining time until year-end 2021 was getting shorter, many corporates reviewed their need of currency options and decided on cancelling drawdowns in optional currencies like GBP, CHF and JPY and sometimes even USD. By choosing this alternative there was no need to convert the loan agreement before year-end 2021.

- It remains to be seen if the forward-looking Term SOFR will take hold in Europe on a broad scale. The Alternative Reference Rates Committee (ARRC) had announced at the end of July 2021 that, as an alternative to the backward-looking SOFR, a forward-looking Term SOFR rate could be used for multi-lender facilities if a switch to the robust SOFR and SOFR average rates proved difficult. At the same time the ARRC confirmed that it would not support Term SOFR for the broad derivatives market. Consequently, a substantial Term SOFR derivatives market has still to evolve to allow adequate refinancing of Term SOFR based loans. With no appropriate derivatives market, base risks currently have to be hedged with SOFR Compounded, leading, also in view of market price risks, to additional costs that will be carried on to the loan side.

Highlights and Market Observations since 14 October 2021 (2/7)

- So far, in Europe the usage of Term SOFR – as well as Term SONIA - has been observed in trade finance transactions, that cannot work with backward looking rates.

- On 13 December 2021 the Working Group on Euro Risk-Free Rates (WGRFR) issued a Statement on Preparedness for the cessation of EUR, GBP, CHF and JPY LIBORs and EONIA, and ceasing use of USD LIBOR in new contracts, at the end of 2021.
  - Market participants were encouraged to proactively complete the transition of existing contracts where possible and otherwise ensure that robust fallback solutions were in place. The WGRFR emphasized once again that proactive transition is seen as key to maintaining financial stability, continuity of contracts and market integrity.
  - WGRFR recommendations:
    - → Adoption of the Euro Short-Term Rate (€STR) plus 8.5 basis points as the alternative to EONIA in legacy contracts.
    - → For EUR, GBP, CHF, and JPY LIBORs adoption of the selected alternative RFRs identified by the relevant national working groups in new and legacy contracts.
    - → Support of the guidance published by the US regulatory authorities to cease use of USD LIBOR in new contracts as of the end of 2021 (except for limited use cases).
    - → Reference to statutory replacement rates for EONIA, GBP/CHF/JPY LIBOR, no statutory replacement rate available for EUR LIBOR. Market participants should proactively transition to an alternative benchmark rate or update to robust RFR fallbacks as soon as practicable.
  - The Chairman of the EUR WGRFR had sent a letter to the European Commission formally requesting the designation of a statutory replacement rate for GBP and JPY LIBORs under the EU Benchmarks Regulation. Outcomes remain pending at this time.

  https://www.esma.europa.eu/sites/default/files/library/rfrwg_statement_on_dec_2021_cessation_events.pdf

Highlights and Market Observations since 14 October 2021 (3/7)

- On 21 October 2021 the European Commission confirmed the designation of the Euro Short-Term Rate (€STR) as published by the European Central Bank as statutory replacement for the benchmark Euro Overnight Index Average (EONIA). This statutory replacement rate will apply to all contracts and financial instruments under the Markets in financial instruments directive from 3 January 2022 that have not been proactively transitioned or been updated with robust RFR fallbacks.
  - Substitution of EONIA by €STR plus an adjustment spread of 0.085%

Replaced benchmark	Replacement Rate	Spread Adjustment Value (%)
EONIA ISIN EU0009659945	Euro short-term rate (€STR) ISIN EU000A2X2A25	0,085

Source: COMMISSION IMPLEMENTING REGULATION (EU) 2021/1848 of 21 October 2021

https://op.europa.eu/en/publication-detail/-/publication/34bfd216-32d2-11ec-bd8e-01aa75ed71a1/language-de/format-PDF/source-search

- The bulk of the EONIA-based contracts in the market was transitioned to €STR plus the above mentioned 0.085%, with some of the contracts alternatively adapting the margin by the relevant adjustment spread. Only in very few cases we observed corporates not accepting the economic differences between the old and the new benchmarks, with the consequence that the transition in already narrow-margin business was at the expense of the banks.

- Furthermore, we observed that facility agreements were actively amended, even if only the EONIA had to be replaced and could have been covered by EU law if need be. Very few exceptions to this proactive approach were related to, for example, upcoming refinancings that were already being negotiated for early 2022 and where it was easier to make temporary use of the EU statutory law for EONIA transition until the signing of the new transaction.

Highlights and Market Observations since 14 October 2021 (4/7)

- On 22 October 2021 the European Commission confirmed the designation of Swiss Average Rate Overnight (SARON) compounded in advance as the statutory replacement rate for CHF LIBOR. Starting 1 January 2022, this replacement rate will apply to all contracts and financial instruments under the Markets in financial instruments directive that have not been proactively transitioned or been updated with robust RFR fallbacks.
  - 1/3/6/12M CHF LIBOR is replaced by 1/3/6/12M compounded Swiss Average Rate Overnight (SARON), as observed over the 1/3/6/12-month period preceding the interest period.
  - The spreads set by ISDA on 5 March 2021 and published by Bloomberg (historical median spread between CHF LIBOR and the respective SARON) are added to these fixed replacement rates as a fixed spread adjustment for each relevant maturity.

LIBOR	TENOR	Replacement Rate	Spread Adjustment Value (%)
CHF	1M	SARON 1 month Compound Rate (SAR1MC) ISIN CH0477123886	-0,0571
CHF	3M	SARON 3 months CompoundRate (SAR3MC) ISIN CH0477123902	0,0031
CHF	6M	SARON 3 month CompoundRate (SAR3MC) ISIN CH0477123902	0,0741
CHF	12M	SARON 3 month CompoundRate (SAR3MC) ISIN CH0477123902	0,2048

Source: COMMISSION IMPLEMENTING REGULATION (EU) 2021/1847 of 14 October 2021

https://op.europa.eu/en/publication-detail/-/publication/cd87fd80-30e8-11ec-bd8e-01aa75ed71a1/language-de/format-PDF/source-search

Highlights and Market Observations since 14 October 2021 (5/7)

- Since 1 January 2022, GBP and JPY LIBOR rates have either been discontinued or - as prescribed by the UK regulator FCA - switched to a "synthetic" methodology. In the past, the EU Commission was advised by numerous credit industry associations of the need for a legally secure solution for dealing with existing contracts. At the beginning of January the EU Commission now announced a legal approach for a designation of statutory replacement rates for selected GBP and JPY LIBOR rates. The corresponding implementing acts are to be adopted in the first quarter of 2022.

- In light of the impending cessation of LIBOR and EONIA the European Banking Authority (EBA) published a thematic note on 14 October 2021 on risks, that parties may face when transitioning from LIBOR to an alternative benchmark rate. The EBA Note recommends the diligent and timely management of the transition process by market participants and stresses the importance of involving all relevant parties in the transition process, including banks, clients, other counterparties, regulators and supervisors.

  In the note a number of important points are highlighted, including:

  - When transitioning away from benchmark rates there are heightened risks for market participants given their pervasiveness in daily business.
  - Over 25% of the EU / EEA banks' derivatives exposures are linked to LIBOR, amounting to nearly EUR 50tn (notional amount) whilst around EUR 1tn of loans are linked to LIBOR rates and EUR 200bn linked to EONIA rates. The EBA Note identifies pockets of transition risks faced by EU / EEA banks due to these significant exposures.
  - LIBOR-referenced loans and advances are a particular focal point for risk, as their transition risk might be higher than for other LIBOR-linked exposures, and CHF LIBOR referenced loans, specifically, carry additional political risks.
  - The transition away from existing to alternative benchmark rates poses several risks. In many cases banks are required to undertake changes to existing contracts at a granular level. These changes usually require significant operational efforts and are accompanied by legal risks, including conduct risks.

  https://www.eba.europa.eu/eba-points-still-elevated-benchmark-rate-transition-risks

Highlights and Market Observations since 14 October 2021 (6/7)

- On 1 October 2021, the Riksbank, Sweden's central bank, started its publication of average rates and an index based on SWESTR.
  - The purpose of these average rates is the application in new financial contracts and as an alternative interest rate in the event of STIBOR (Stockholm Interbank Offered Rate) being discontinued or becoming temporarily unavailable. Therefore, the Riksbank will publish average rates for periods of 1 week, 1 month, and 2, 3 and 6 months.
  - Since the average rates are based on published values for SWESTR as from 1 September 2021, publication of average rates for the time periods 1 week and 1 month started on 1 October 2021, followed by the average rates for 2 and 3 months on 1 November 2021 and 1 December 2021 respectively with the 6 months average rates being published from 1 March 2022.
  - The index allows users to easily calculate average rates for any time period.

  https://www.riksbank.se/en-gb/press-and-published/notices-and-press-releases/notices/2021/the-riksbank-today-starts-publishing-average-rates-and-an-index-for-swestr/
  https://www.riksbank.se/globalassets/media/statistik/swestr/information-document-comprehensive-information-on-sveriges-riksbanks-framework-for-swestr.pdf

- On 30 September 2021, the CIBOR administrator, the Danish Financial Benchmark Facility (DFBF), announced that its public consultation on the cessation of three CIBOR tenors had been completed.
  - The consultation focused, amongst other things, on the clarification of the CIBOR definition and the timeline for the cessation of CIBOR. Following the conclusion of the consultation, DFBF will cease the provision of 2-week, 2-month and 9-month CIBOR tenors from 31 March 2022.
  - The new CIBOR definition is as follows:

    “CIBOR being the rate of interest, at which a Panel Bank would lend DKK, if they were to do so, for a period of 1 week, 1, 3, 6, and 12 months' maturity to a prime bank on an uncollateralized basis (i.e. unsecured interbank loan)”.

    https://dfbf.dk/consultation-on-cessation-of-tenors-concluded/

Highlights and Market Observations since 14 October 2021 (7/7)

- The previous IBOR reference rates include a credit element that reflects the banks' cost and risk of lending over a period of time. With the new risk-free overnight rates, the credit risk is lower. As a rule, these rates are lower than the old IBOR benchmarks, so that a so-called credit adjustment spread was agreed upon to economically compensate for the transition from the old to the new benchmark. The derivatives market uniformly converted GBP/CHF/JPY/EUR LIBOR transactions to RFRs using the credit adjustment spreads set by ISDA on 5 March 2021 and published by Bloomberg. These were determined on the basis of a historical 5-year median as at the adjustment date of 31 December 2021. On the credit side, according to our observations, around 99% of the converted investment grade loans followed this methodology, which is also used in the statutory regulations for EONIA/GBP/CHF/JPY contracts not converted by 31 December 2021. Only rarely, instead of using a credit adjustment spread, was the economic compensation reflected in a margin increase. For new transactions or future contract extensions, it is possible to reprice transactions directly on the basis of the new benchmarks and without using a spread adjustment.

  https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf

Highlights and Market Observations since 14 October 2021 (1/6)

- On 16 November 2021, the UK's Financial Conduct Authority (FCA) confirmed availability of synthetic LIBOR rates and permitted use in all legacy LIBOR contracts that could not been changed at or ahead the end of 2021.
  - ICE Benchmark Administration Limited will continue publishing 1/3/6M GBP and JPY LIBOR settings in 2022, but under a 'synthetic' methodology. The synthetic GBP and JPY LIBOR rates are being calculated using a forward-looking term version of the relevant risk-free rates SONIA and TONA(R) together with the ISDA spread adjustments set on 5 March 2021 and published by Bloomberg, which are being used in the derivatives business.
  - Publication is expected to be limited to the period 4 January 2022 to 31 December 2022 (FCA reserves option to extend).
  - The synthetic rates are not available for use in new contracts.
- In a separate note the FCA also confirmed that USD LIBOR would not be permitted for use in new contracts from 1 January 2022 (with very limited exceptions). The FCA reiterated that, despite the temporary availability of synthetic LIBOR, market participants should continue to transition to alternative rates where possible.

https://www.fca.org.uk/news/press-releases/fca-confirms-rules-legacy-use-synthetic-libor-no-new-use-us-dollar-libor

https://www.fca.org.uk/publication/libor-notices/article-23c-benchmarks-regulation-draft-permitted-legacy-notice.pdf

https://www.fca.org.uk/publication/libor-notices/article-21a-benchmarks-regulation-prohibition-notice.pdf

https://www.fca.org.uk/publication/libor-notices/annex-4-benchmarks-regulation.pdf

https://www.fca.org.uk/publication/feedback/fs21-11.pdf

Highlights and Market Observations since 14 October 2021 (2/6)

- On 15 October 2021, the FCA had launched a questions and answers page (FAQs) on its website, addressing the frequently asked questions it had received in relation to its powers under the UK Benchmarks Regulation and the publications that the FCA made on 29 September 2021 regarding the publication of synthetic LIBOR rates.
  - The FAQs address
    - → the use of synthetic LIBOR after end-2021
    - → the impact of synthetic LIBOR on contractual provisions
    - → general information and guidance on synthetic LIBOR's implementation and its use
    - → interaction of synthetic LIBOR with other jurisdictions

    https://www.fca.org.uk/markets/about-libor-transition/libor-and-fcas-powers-under-uk-benchmarks-regulation-questions-and-answers

- On 10 December 2021 the FCA released various materials ahead of the cessation of LIBOR including a Feedback Statement (FS21/12) following its September 2021 consultation on the use of synthetic LIBOR from October 2021 (CP21/29). The FCA again reminded market participants that active transition should continue to be a priority, and that it would continue to measure market progress on this front.

  https://www.fca.org.uk/news/news-stories/final-messages-libor-end-2021

- In a technical notice the FCA ensured that the legacy use of synthetic LIBOR would come into effect at the same time as the overall prohibition on new use.

  https://www.fca.org.uk/publication/libor-notices/article-23b-benchmarks-regulation-prohibition-article-21a-notice.pdf

Highlights and Market Observations since 14 October 2021 (3/6)

- The Feedback Statement covers various topics raised by responses to the Consultation, including, amongst other things:
  - → The scope of the FCA's powers with respect to synthetic LIBOR; in particular, whether it covers secondary market activities and certain types of loans
  - → The broad use case applied to synthetic LIBOR rates and the need for continuing active transition to RFRs
  - → Adequate contract provisions to deal with a prohibition on use
  - → Requests for further clarity on the new use restriction power
  - → Implementation of the FCA's proposals, including requests for further clarity on future decisions re synthetic LIBOR
  - → International consistency and coordination

  https://www.fca.org.uk/publication/feedback/fs21-12.pdf

- In his speech on 8 December 2021 made at Risk.net's LIBOR telethon, Edwin Schooling Latter, Director of Markets and Wholesale Policy and Supervision at the FCA, confirmed that the SONIA-linked commercial loans market had quickly surpassed GBP 100bn and substantial progress had been made in converting existing GBP LIBOR loans to SONIA. The pace of transition in both Europe and the US was seen as more developed than was expected a year ago.

  Mr. Schooling Latter also reiterated the temporary nature of synthetic LIBOR, noting that the case for 3-month GBP LIBOR was stronger than for the other tenors. All the synthetic rates will cease in due course, and none will be continued simply for the convenience of those who could take action to convert, but have not bothered to do so.

  https://www.fca.org.uk/news/speeches/so-long-libor-3-weeks-to-go

Highlights and Market Observations since 14 October 2021 (4/6)

- On 12 November 2021, the UK's Office of Gas and Electricity Markets (Ofgem) published a guidance letter to offshore transmission owners (OFTO) with respect to the transition from LIBOR to SONIA.
  - In particular, it was addressed whether the shift would be considered as a 'Qualifying Refinancing' under amended standard condition E12-J3 of the offshore transmission license.
  - In light of the FCA's guidance that the transition from LIBOR to SONIA should be on the basis of no gain or detriment to either the borrower or lender, Ofgem confirmed its considerations that any such refinancing should not be considered a Qualifying Refinancing under the Condition. Also, the letter outlines requirements that OFTOs must meet to satisfy the authorities that they will not gain from the refinancing

  https://www.ofgem.gov.uk/publications/discontinuation-libor-and-transition-sonia-guidance-offshore-transmission-owners

- On 11 October 2021, the UK's Infrastructure and Projects Authority (IPA) published a guidance note on the impact of the cessation of LIBOR on private finance initiative (PFI) projects. The PFI Guidance Note is an update on the previous IPA guidance notes from February and July 2021 and provides guidance and sets out matters that authorities should consider in respect of the transition away from GBP LIBOR to SONIA.
  - Guidance topics include: procuring authority considerations for the LIBOR transition; authority consent for the transition; increase in compensation on termination liability; consent not unduly withheld or linked to other issues; and procuring authority costs and reimbursement matters.
  - FAQs and specimen consent letters shall help supporting the authorities when dealing with the transition away from LIBOR.

  https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1024462/PFI_Guidance_Note_-_Discontinuation_of_LIBOR_-_applied_to_PFI_Projects_-_October_2021.pdf

Highlights and Market Observations since 14 October 2021 (5/6)

- Term SONIA
  - The Working Group on Sterling Risk-Free Reference Rates (RFRWG) consulted on the concept of SONIA in 2018. Following this, the Working Group identified the need for a forward-looking reference rate for some participants in the cash markets and to support the conversion of certain legacy contracts.
  - In December 2018, the RFRWG issued a statement inviting interested benchmark administrators to review the findings on the Term SONIA Reference Rate (TSRR) consultation and provide their views on the development of such benchmarks. Initially, three benchmark administrators provided beta TSRRs during 2020 that could be used for testing purposes. Since then, ICE Benchmark Administration and Refinitiv have been publishing corresponding Term SONIA rates for use in financial contracts.
  - The RFRWG has repeatedly recommended that the market move broadly to Compounded SONIA, noting that the use of a Term SONIA rate is limited.
  - The RFRWG's Term Rate Use Case Task Force was formed to identify where the use of compounded SONIA is appropriate and to provide guidance on where the use of alternative approaches, such as a term SONIA rate, may be necessary.
  - In a drafting of the RFRWG from 01/2020, the scope of the Term SONIA Rate was analyzed in detail (please see next page).
  - The GBP LIBOR market started transitioning to Compounded SONIA in arrears early on. The transition is straightforward and uniform, a fragmentation between different alternative new benchmarks like in the US-market is not seen in the GBP-LIBOR market.
  - So far, we observe a use of Term SONIA rates within the defined scope of use. A broader application of the rate, similar to the use of Term SOFR, is currently not expected by the market.

Highlights and Market Observations since 14 October 2021 (6/6)

- Term SONIA – Scope of use:

Products	Client Breakdown	Details	Definition	Balance %	Recommended Rate
Bonds/ Loans/ Trade	Large Corporate/ Leverage	Sponsor/ Leverage Large Corporate	Corporate deals/ Sponsor lead acquisitions/ recapitalisations with a deal size £25m	50%	Compounded in Arrears
Loans/ Trade	Mid to Large Corporate/ Specialist Finance	Financial Institutions	Banks, insurance providers, asset managers, funds, hedge funds and broker dealers	40%	
		Mid to Large Corporates	Annualised revenue >£25m and deal size £10-£25m.		Compounded in Arrears
		Social Housing	Lending to Social Housing firms		Compounded in Arrears
		Education/ Local Authority	Lending to schools/ Higher Education/ Local Authorities		
		Project Finance	Financing of a major independent capital investment		
		Real Estate	Commercial Real Estate firms		
	Export Finance/ Emerging Market	Export Finance	Funding to outsized capital expenditure with export finance guarantee	10%	Term/ Alternative Rate
		Emerging Markets	Lending to emerging markets		
	Mid Corporate/ Private Banking & Retail	Mid Corp	Annualised revenue >£6.5m and <£25m. Excludes specialised lending		Term/ Alternative Rate
		Small, Micro Size Enterprise	Annualised revenue <£6.5m		
		Retail Mortgages	Retail clients		
		Wealth/ Private Bank	Offers Banking and affluent clients, families and fiduciaries based in the UK, offshore or emerging markets		
Product Exception	Trade & Working Capital	Trade & Working Capital	All Trade & Working Capital products including discounting/ Letters of credit, supply chain finance etc		
	Islamic Finance	Islamic Finance	Islamic facilities forbid interest payments on loans		

- Source:

  https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/use-cases-of-benchmark-rates-compounded-in-arrears-term-rate-and-further-alternatives.pdf?la=en&hash=22BA20A8728D9844E5A036C837874CA3E70FEAE1

- Other useful links:

  https://fmsb.com/wp-content/uploads/2021/07/Standard-on-use-of-Term-SONIA-reference-rates_FINAL.pdf
  https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfrwg-term-sonia-reference-rate-summary.pdf

Highlights and Market Observations since 14 October 2021 (1/7)

- New USD loans on SOFR loans
  - There are several forms of SOFR that parties in business loans may potentially choose to use, including Daily Simple SOFR in Arrears, Daily Compounded SOFR in Arrears, forward looking Term SOFR and SOFR Averages (Applied in Advance).
  - In view of market preferences to know the interest rate in advance, the ARRC recognizes that syndicated and bilateral business loans may be based on the SOFR Averages (Applied in Advance) or forward looking term SOFR ("Term SOFR").

Main Characteristics / Recommended Conventions	SOFR Averages	Term SOFR
Published periods	Average of the daily overnight SOFR rate over certain periods of time: 30-, 90-, and 180-days, calculated on a compounded basis.	Daily set of forward looking interest rate estimates, calculated and published for 1-/3-/6-/12-month tenors based on market expectations implied from leading derivatives markets.
Scope of use	SOFR Averages reflect movements in interest rates over a given period of time, specifically the prior 30-, 90-and 180-days, and smooth out idiosyncratic day-to-day fluctuations in market rates over that period making them ideal for use in cash products including syndicated and bilateral loans, mortgages, intercompany-loans and securitization. The rate is robust and reliable, rooted in a deep and enduring market with thousands of transactions Parties may consider using the 30-Day Average for all tenor periods, as the shorter observation period ensures a more current rate.	Originally only planned for business segments that cannot work with backward-looking rates, like certain trade finance business the scope was broadened in July 2021 when the Alternative Reference Rates Committee (ARRC) announced, that, as an alternative to the backward-looking SOFR, a forward-looking Term SOFR rate could be used for multi-lender facilities if a switch to the robust SOFR and SOFR average rates proved difficult. At the same time the ARRC confirmed that it would not support Term SOFR for the broad derivatives market. Consequently, a substantial Term SOFR derivatives market may not evolve to allow adequate refinancing of Term SOFR based loans.

Highlights and Market Observations since 14 October 2021 (2/7)

Main Characteristics / Recommended Conventions	SOFR Averages	Term SOFR
Administrator	Federal Reserve Bank of New York (“FRBNY”)	CME Group Benchmark Administration Ltd
Publication Schedule	The publication of SOFR Averages follows the FRBNY publication schedule of SOFR.	CME's Term SOFR Rates will be calculated for each day the FRBNY calculates and publishes SOFR.
Holiday and Weekend Convention	Any day that is not a US Government Securities Business Day.	
Lookback	Use the rate published two US Government Securities Business Days prior to the first day of the interest period and held for the entirety of the interest period, similar to the LIBOR convention.	
Daycounts	Actual/360 days, which is the standard convention in US money markets; however, it is possible to use other day-count fractions (e.g., Actual/365 days).	
Business Day Convention	“Modified Following Business Day” convention	
Interest Rate Floors	For new loans, it is recommended that any interest rate floor apply.	
Rounding	Like LIBOR today, Term SOFR and SOFR Averages are published to five decimal places and dollar amounts can be calculated to two decimal places and, thus, parties may consider using their current rounding practices.	
Borrowing Notice Period	Borrower to provide notice of a borrowing request three US Government Securities Business Days prior to the borrowing date, similar to the LIBOR convention.	
Fallback Language	Loans to include robust, workable fallback language as recommended by ARRC.	

https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/Term_SOFR_Avgs_Conventions.pdf

https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20210511-guide-to-published-sofr-averages

Highlights and Market Observations since 14 October 2021 (3/7)

- Term SOFR rates are available for licensing in cash market financial products and derivatives that hedge cash instruments linked to the Term Rates, and certain securitizations with underlying assets that are themselves tied to Term SOFR Reference Rates.
  - Licensing for cash market financial products will be available at no cost through December 2026, whereas licensing for permissible derivatives is based on fair, reasonable and non-discriminatory (FRAND) principles, with a market standard pricing schedule.
  - According to CME Group's terms and conditions, an end user does not need a Use License for CME Term SOFR simply to enter into a transaction. This means, that a corporate borrower does not need a license for Term SOFR based borrowing. If, however, the end user/borrower wishes to use Term SOFR in a system for purposes of valuation, analysis risk/collateral management, among other things, a license would be required.

    https://www.cmegroup.com/market-data/files/cme-term-sofr-reference-rates-faq.pdf

- Back in March 2021 the Alternative Reference Rates Committee (ARRC) had selected Refinitiv as its chosen provider to publish ARRC-recommended fallback rates for cash products based on the Secured Overnight Financing Rate (SOFR), the ARRC's preferred alternative to USD LIBOR.
  - On 30 November 2021 the ARRC welcomed Refinitiv's announcement about the availability of its USD IBOR Institutional Cash Fallbacks for immediate use as production benchmarks as well as the launch of its USD IBOR Consumer Cash Fallbacks for 1-week and 2-month settings on 3 January 2022 (pending final approvals).
  - Refinitiv's Cash Fallbacks are for use in contracts that contain ARRC-recommended fallback provisions to address instances where USD LIBOR ceases or is non-representative. There are two versions of the Refinitiv USD IBOR Cash Fallbacks: one for institutional cash products and one for consumer cash products.

Highlights and Market Observations since 14 October 2021 (4/7)

→ USD IBOR Institutional Cash Fallbacks are available for use in financial contracts. The adjusted SOFR component includes SOFR compounded in arrears, and the daily simple SOFR and SOFR compounded in advance.

→ The USD IBOR Consumer Cash Fallbacks are based on compounded SOFR in advance plus the spread adjustment, which is gradually introduced during the 12 month transition period following LIBOR cessation or permanent loss of representativeness.

https://www.refinitiv.com/en/media-center/press-releases/2021/november/refinitiv-launches-usd-ibor-institutional-cash-fallbacks-in-production-to-facilitate-industry-transition-from-usd-libor

- On 14 October 2021, the ARRC released a statement recommending that market participants treated the remaining weeks until the end of the year as a vital window in which to reduce their use of USD LIBOR in preparation for this and other deadlines.
  - In light of supervisory guidance from a variety of jurisdictions to cease use of new USD LIBOR as soon as is practicable and, in any event, by 2021 year-end, the ARRC reiterated its recommendation of adopting SOFR as the benchmark that market participants transition to.
  - Practical steps for market participants to adopt to ensure no new use in USD LIBOR by year-end include setting targets for reductions in new LIBOR activity, limiting the range of LIBOR offerings, and implementing internal escalation exceptions processes around new LIBOR contracts for narrow cases in line with supervisory guidance.
  - The ARRC believes that adopting a proactive approach over a period of time – rather than at a defined end point under which prevailing liquidity conditions could have an outsized impact – is in the interest of smooth market functioning. A proactive approach to reducing new USD LIBOR use should be used across markets and across the full range of derivatives and cash products, including but not limited to syndicated and bilateral loans.

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20211013-arrc-press-release-supporting-a-smooth-exit-post-arrc

Highlights and Market Observations since 14 October 2021 (5/7)

- On 6 October 2021, the ARRC released a summary of its recommendations and work to-date on spread-adjusted fallbacks for contracts referencing USD LIBOR.
  - The purpose of this publication was to provide a single document containing key details of the recommendations that the ARRC has made or intends to make in relation to its fallback language and the state legislation that references the ARRC recommended fallbacks.
  - The ARRC's recommended spread-adjusted fallbacks apply to USD LIBOR contracts that contain the ARRC's recommended hard-wired fallback language or to older USD LIBOR contracts for which a spread-adjusted SOFR fallback may be elected. They also apply to USD LIBOR contracts covered by state legislation that references the ARRC recommended fallbacks.
  - In addition to the ARRC's recommendations on spread adjustment, the summary also explains the ARRC Guiding Principles and the promotion of state and federal legislation that provide robust fallback options for contracts that do not contain a clear fallback provision.

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20211006-arrc-release-spread-adjustment-narrative-final
  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/spread-adjustments-narrative-oct-6-2021

- On 19 November 2021, the Federal Reserve (the Fed) released an FAQ document addressing some outstanding matters in the transition away from LIBOR.
  - A credit agreement that is automatically renewed after 31 December 2021 is considered a new agreement.
  - The Fed defined limited cases where it would be appropriate for parties to enter into new USD LIBOR contracts after year-end 2021, but reminded parties to have reasonable measures in place to assess whether a new USD LIBOR contract would be consistent with safety and soundness practices.
  - The statement also confirms that parties may engage in secondary trading of LIBOR-linked instruments issued prior to 31 December 2021. https://www.federalreserve.gov/supervisionreg/srletters/sr2112.htm

Highlights and Market Observations since 14 October 2021 (6/7)

- On 20 October 2021 the Office of the Comptroller of the Currency (OCC) and other Federal regulatory agencies (the Agencies) issued a statement promoting an orderly transition away from LIBOR.
  - In light of the regulatory guidance for parties to not enter "new" LIBOR contracts after the end of 2021, the Agencies suggest that a "new" contract would include an agreement that: (i) creates additional LIBOR exposure; or (ii) extends the term of an existing LIBOR contract. A draw on an existing agreement that is legally enforceable (e.g., a committed credit facility) would not be viewed as a new contract.
  - Contracts entered into before the end of 2021 should look to use an alternative reference rate appropriate to parties' risk profiles, funding models, and customer needs, or have appropriate fallback language. Consideration should be given to the rate's underlying markets, construction and fragilities.
  - The statement advises parties to identify all contracts that reference LIBOR, lack adequate fallback language, and will mature after the relevant tenor ceases. Fallback language should be used in new or updated contracts that provides for using a strong and clearly defined fallback rate when the initial reference rate is discontinued.
  - The Agencies identify four limited circumstances in which continuing to use LIBOR may be necessary to ensure a safe, sound, and orderly transition (for example, novation of USD LIBOR transactions executed before 1 January 2022). Best practice for making use of these exceptions should include clear internal governance and oversight.
  - Supervisory focus would continue to increase as the LIBOR cessation date approaches.

  https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-48.html

  https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-48a.pdf

Highlights and Market Observations since 14 October 2021 (7/7)

- On 5 October 2021, Randal Quarles, Vice-Chair of the US Federal Reserve, made a speech pertaining to the end of LIBOR, reiterating upcoming deadlines and steps that market participants must take to ensure a timely and successful transition to alternative reference rates.
  - In his speech, Mr. Quarles set out the well-documented failings of LIBOR, and reiterated certain impending deadlines in the transition away from the benchmark. Especially his statement, that the 2021 year-end deadline for any "new" use of overnight, 1-, 3-, 6- and 12-month USD LIBOR, which will not become unrepresentative until July 2023, means that market participants must continue to push for active transition, is worth highlighting.
  - Mr. Quarles noted that this deadline has led various market participants to seek guidance on what constitutes a "new" use of LIBOR. The Federal Reserve is working with other agencies to provide additional guidance on this issue. However, in Mr. Quarles' view, "new" use would include any agreement that creates additional LIBOR exposure for a supervised institution or extends the term of an existing LIBOR contract.
  - Mr. Quarles insisted that there will be no deadline extensions for market participants, highlighting that parties now have all of the tools necessary from regulatory bodies to successfully transition to alternative reference rates.
  - Whilst regulatory bodies insist that capital and derivatives markets transition to SOFR, with respect to loans, use of other rates is acceptable if it is most appropriate for parties' funding models and customer needs.

  https://www.federalreserve.gov/newsevents/speech/quarles20211005a.htm

Highlights and Market Observations since 14 October 2021 - Derivatives Markets (1/2)

- On 9 December 2021 the Working Group on Euro Risk-Free Rates ("WGRFR") had issued recommendations on the cross currency swap conventions:
  - Alignment with the CFTC Market Risk Advisory Committee's part II of the RFR First initiative in EU interdealer cross currency swap markets
  - Adoption of €STR for the EUR leg of EUR vs USD cross currency swaps in the EU interdealer market from 13 December 2021

    https://www.esma.europa.eu/sites/default/files/library/eur_rfr_wg_-_statement_-_rfr_first_for_cross_currency_swaps.pdf

- As another big step in IBOR transition, clearing houses converted EONIA trades worth EUR 364 billion notional to €STR-flat in a milestone transaction coordinated by Eurex Clearing over the weekend 16-17 October 2021. The 8.5 basis points spread between the two reference rates was compensated by cash settlement on 19 October 2021. The transition of CHF, GBP and JPY LIBOR references to their respective risk-free rates followed in December 2021, shortly before their fallback provisions were triggered immediately after 31 December 2021.

  https://www.eurex.com/ex-en/find/news/IBOR-reform-moves-forward-legacy-transactions-successfully-converted-to-STR-2813492

- To support the market's transition away from LIBOR, Refinitiv introduced the Tokyo Swap Rate (for swaps referencing TONA(R)), which supports the new TONA(R) market convention. Refinitiv uses the Tokyo Swap Rate with a constant spread adjustment to produce prototype Tokyo Swap Rate Fallback settings, with plans to create a benchmark in 2022.

  https://www.refinitiv.com/en/financial-data/financial-benchmarks/tokyo-swap-rate

Highlights and Market Observations since 14 October 2021 - Derivatives Markets (2/2)

- In its October 2021 Policy Statement the FCA set out its finalised amendments to the UK regulatory technical standards (RTS) on the derivatives trading obligation (onshored Commission Delegated Regulation (EU) 2017/2417) exercising its powers under Article 32(5) of UK MiFIR and section 138P of the Financial Services and Markets Act 2000 (FSMA). The amendments to the RTS were to come into force on 20 December 2021.

  https://www.fca.org.uk/publication/policy/ps21-13.pdf

- In its FAQs published on 15 October 2021 on its new powers under the UK Benchmark Regulation, the FCA addressed, among other things, the use of synthetic LIBOR and the impact on contractual provisions.

  https://www.fca.org.uk/markets/about-libor-transition/libor-and-fcas-powers-under-uk-benchmarks-regulation-questions-and-answers

- The Interest Rate Benchmark Reform Subcommittee of the Commodity Futures Trading Commission's (CFTC) Market Risk Advisory Committee (MRAC) continued its "SOFR First" initiative to include non-linear derivatives.
  - Following the interdealer conventions transition to trade SOFR linear swaps (26 July 2021) and cross-currency swaps using JPY, GBP and CHF alternative reference rates (21 September 2021), the third phase of the SOFR First initiative was completed on 8 November 2021, as interdealer trading conventions for USD non-linear derivatives transitioned from USD LIBOR to SOFR.
  - Intercontinental Exchange (ICE) Benchmark Administration (IBA) launched its USD SOFR ICE Swap Rate for SOFR interest rate swaps and USD SOFR Spread-Adjusted ICE Swap Rate for the non-linear market, marking further progress in the linear swaps market and helping to catalyze the shift in the non-linear market.
  - The fourth and final phase of the "SOFR First" initiative will involve exchange-traded derivatives with timing to be confirmed.

Messages to take away for 2022 (1/2)

- Transition of EONIA and GBP/EUR/CHF/JPY LIBOR legacy facilities
  - Statutory regulations for tough legacy can only be a temporary, but not a permanent solution
  - Availability of synthetic GBP/JPY LIBOR limited to 2022
  - Optional currency draw-stops might only be a temporary solution

    ➢ Tackle any outstanding issues in a timely manner

- High amount of USD legacy business still to be transitioned
  - Publication of remaining USD LIBOR rates to end on 30 June 2023
  - Development of synthetic rates uncertain and cannot be relied upon
  - Different new benchmarks at disposal for USD LIBOR transition
  - Borrowers observing development of market conventions for new USD business
  - Diversity of SOFR rates and alternative RFRs available for the domestic US-market
  - Strong European interest in US-developments, especially regarding potential Term SOFR use in syndicated loans in Europe
  - Multiple solution options lead to fragmented USD market

    ➢ Borrowers need to find appropriate solution for their individual situation

    ➢ Use remaining time wisely (especially if systems need to be adopted)

    ➢ Once the directions are clear actively transition USD legacy loans wherever possible

Messages to take away for 2022 (2/2)

- Operational readiness
  - Systems implementation at borrowers and lenders partly still ongoing
  - Partial use of manual workarounds until full operational readiness
  - Changes in market conventions (like for example rounding in calculating compounded RFR rates) might require system updates
  - Forward-looking RFRs only available for limited scope of business, amend systems where necessary to backward-looking approach

    ➢ Address any outstanding challenges in a timely manner

- Further development on EURIBOR Fallbacks definitions expected for 2022

- Loan market transition to RFRs moving at different pace
  - Pockets of the market (e.g. developing markets) need to catch up

    ➢ Continue with market education and speed up transition

Useful sources of information for current developments

For latest information as well as general details on the transition from IBORs, please also refer to information published by supervisory authorities, working groups and other industry organisations. A selection of the most important websites can be found here:

	€STR: European Central Bank EURIBOR: Emmi Working Group on Euro Risk-Free Rates
	Bank of England Financial Conduct Authority
	Federal Reserve Bank of New York The Alternative Reference Rates Committee (ARRC)
	SIX Swiss Exchange National Working Group on Swiss Franc Reference Rates (SNB)
	Bank of Japan Cross-Industry Committee on Japanese Yen Interest Rates Benchmarks
	ISDA Loan Market Association (LMA) LSTA

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