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Newsletter IBOR Reform 04/2022

Compilation by the Helaba IBOR Task Force

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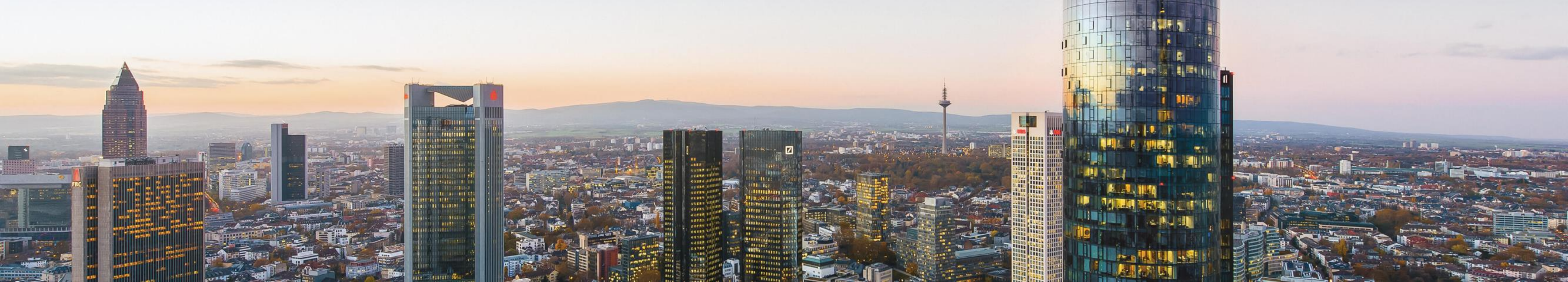
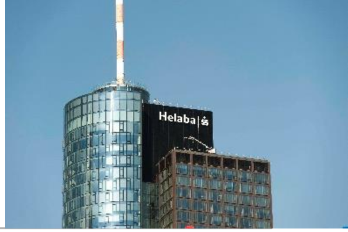


Foreword by Helaba IBOR Task Force



Ladies and Gentlemen,

Welcome to our second IBOR Reform Newsletter in 2022. What has happened since the historic milestone of 31 December 2021 - the date when EONIA and GBP, CHF, JPY and EUR LIBOR and 1W/2M USD LIBOR reference rates were permanently discontinued?

Since the beginning of this year, all new floating-rate GBP/CHF/JPY/USD business has to be concluded on the basis of the risk-free overnight rates (RFRs) introduced last year. EONIA has completely given way to €STR.

While some contracts from the first IBOR transition wave still have to be converted, the financial markets are already preparing the transition of USD LIBOR contracts, which is much more extensive in terms of volume and figures. It is true that USD LIBOR can still be used for USD legacy business in the most common maturities until 30 June 2023. However, in view of the corresponding lead times for negotiations and contract conversions, the necessary conversions should be tackled in good time, especially if they can be combined with extensions and refinancing, for example.

In our last newsletter dd. 14 January 2022 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.

As always, we are at your disposal for a personal exchange, for the structuring of new transactions on RFR basis as well as for the conversion from 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 January 2022 (1/5)

- In 2021, USD LIBOR in loan agreements was either switched to SOFR compounded, optional currency options were suspended by clients or the switch to USD LIBOR was postponed. In Q4/2021, there were isolated conversions to term SOFR, especially in trade finance transactions where backward-looking rates cannot be used.
- The Alternative Reference Rates Committee (ARRC) had, at the end of 07/2021, allowed the use of the forward-looking term SOFR as an alternative to the backward-looking SOFR for multi-lender facilities, in case a switch to the robust SOFR and SOFR average rates proved difficult. At the same time, the ARRC confirmed that it would not support the use of the term SOFR for derivatives, particularly in the interbank market.
- As expected, due to the ARRC's recommendation, no liquid term SOFR derivatives market has developed so far. This means that the banks lack an essential instrument to fully manage the resulting basis risks from term SOFR loans.
- According to our observations, corporate financing in Europe has so far almost exclusively switched to SOFR Compounded. Clients from multi-currency facilities are already familiar with the conversion to and processing of backward-looking RFR (e.g. SONIA, SARON, TONA(R)). Only in the asset finance segment, an increasing demand for term SOFR can be observed.
- In the USA, on the other hand, the market is fragmented. Besides SOFR Compounded and Term SOFR, SOFR Average and Simple SOFR Average are also used. For Europe, it is expected that the use of SOFR Compounded and Term SOFR will remain.
- Transition of the USD LIBOR legacy business has to be completed by 30 June 2023. Banks are expected to increasingly approach their customers with transition proposals from the second half of 2022.

Highlights and Market Observations since 14 January 2022 (2/5)

- Temporary 1/3/6-month synthetic LIBOR rates were set up for handling not yet transitioned GBP LIBOR legacy business. With SONIA compounded in arrears fully established in the Sterling market and less than about 2% of LIBOR legacy stock to be outstanding, the FCA will obtain feedback during the course of this year on retiring 1-month and 6-month synthetic sterling LIBOR at the end of 2022, and on when to retire 3-month sterling synthetic LIBOR. On 9 February 2022, the Bank of England, FCA and Working Group encouraged firms to continue to pursue the active transition of legacy sterling LIBOR contracts currently using the temporary synthetic LIBOR.

  Finalising LIBOR transition – achievements in sterling markets and what remains to be done | Bank of England

- On 16 March 2022, ICE Benchmark Administration Limited (IBA) launched its ICE Term SOFR Reference Rates as a benchmark for use in financial instruments by licensees. This launch followed the successful testing of beta versions of the ICE Term SOFR Rates. The ICE Term SOFR Rates measure forward-looking SOFR rates for maturities of 1, 3, 6 and 12 months and are published daily at or about 11:15 a.m. Eastern Time on applicable New York business days. ICE Term SOFR Rates are based on a waterfall methodology using prices and volumes from dealers to customers for eligible SOFR-linked interest rate swaps on Tradeweb's institutional platform to generate ICE Term SOFR settings. In case of insufficient data from eligible traders, Term SOFR settings will be calculated using data from ICE SOFR-linked futures contracts. As market liquidity increases, the IBA also expects to use tradable bid and ask prices and volumes for eligible SOFR-linked interest rate swaps available in the central limit order books of regulated electronic trading venues to generate such settings.

  Intercontinental Exchange - ICE Benchmark Administration Launches ICE Term SOFR Reference Rates as a Benchmark for use in Financial Instruments (theice.com)

Highlights and Market Observations since 14 January 2022 (3/5)

- After having been passed by Congress on 8 March 2022, US President Biden signed into law the Consolidated Appropriations Act 2022 on 15 March 2022. The act includes (among other things) the Adjustable Interest Rate (LIBOR) Act (the Federal Legislation), which provides for, by operation of law, a replacement benchmark based on SOFR to be selected by the Board of Governors of the US Federal Reserve System. The Federal Legislation only applies to contracts governed by US law.

  It aims to eliminate legal uncertainty by providing a uniform, nationwide process for the conversion of outstanding loans, securities, derivatives and other contracts that reference specific maturities of USD LIBOR but do not otherwise contain adequate fallback benchmark provisions to replace USD LIBOR (Tough Legacy Contracts). Tough legacy contracts must switch to the replacement benchmark based on SOFR when USD LIBOR is no longer published on 30 June 2023, and they must also apply any recommended credit adjustment spreads.

  The federal legislation will allow contracts that contain a workable fallback provision to continue to operate without interruption. It will not affect loans using, for example, the Prime Rate or the Federal Funds rate, which means that many syndicated loans subject to US law will fall outside the scope of the federal legislation. The Federal Legislation also aims to limit litigation related to Tough Legacy Contracts.

  The Federal Legislation will supersede state LIBOR transition laws, including Article 18-C of the New York General Obligations Law (with the exception of legacy contracts relating to 1-week and 2-month USD LIBOR, as these are not covered by the Federal Legislation).

  The ARRC welcomed this development as the legislation takes a similar approach to that initially proposed by the ARRC in 2020.

  ARRC-Press-Release-Passage-Federal-LIBOR-Legislation.pdf (newyorkfed.org)
  untitled (house.gov)
  Congress.gov | Library of Congress

Highlights and Market Observations since 14 January 2022 (4/5)

- After 19 months of review and development by the Swedish Financial Benchmark Facility (SFBF) to safeguard the integrity and robustness of the benchmark, STIBOR has fully transitioned to a transaction-based calculation methodology, which calculates in an automated and controlled manner the contributing banks' cost of funds based on the banks' actual funding transactions. As STIBOR is an offered rate, a predetermined Bid to Offer Spread is added to the cost of funds to produce the STIBOR rates.

  Details of this calculation methodology can be found on the SFBF website library.

  The revised methodology continues to measure STIBOR's underlying economic reality in a consistently accurate manner, aligned to the historical and intended use of the benchmark but in providing a more direct and transparent link to observable trade data the methodology is more robust, transparent and provides assurance to users and is designed to meet applicable regulatory requirements. The system is capable of complex calculations and identifying erroneous input and manipulation attempts in tandem with supervision from contributors and SFBF oversight functions.

  The SFBF and the Swedish Financial Supervisory Authority made an application for authorisation under the EU Benchmark Regulation (EU BMR).

  STIBOR can still be used for new and existing transactions for the duration of this application process (as per Article 51, EU BMR).

  STIBOR-transitions-to-transaction-based-calculation-methodology.pdf (swfbf.se)
  SFBF18029-STIBOR-Calculation-Methodology.pdf (swfbf.se)
  Library - Swedish Financial Benchmark Facility (swfbf.se)
  Swedish Financial Benchmark Facility (swfbf.se)

- In terms of a fallback rate, the Swedish Bankers' Association (SBA) has recommended adjusted (compounded) SWESTR plus a spread adjustment. Adjusted SWESTR should be calculated in line with international standards, and in Sweden specifically the calculation will be made according to ISDA principles. The spread adjustment will also be calculated according to ISDA principles (the median difference between STIBOR and compound SWESTR over the previous 5 years).

  recommendation-regarding-a-fallback-rate-for-stibor.pdf (swedishbankers.se)

Highlights and Market Observations since 14 January 2022 (5/5)

- On 18 March 2022, the Denmark Financial Benchmark Authority (DFBF) announced that CIBOR underwent a re-determination in line with the DFBF Benchmarks Post Publication Re-determination Policy.
- On 9 March 2022, the DFBF had already reminded market participants of the cessation of 2-week CIBOR, 2-month CIBOR, and 9-month CIBOR tenors from 1 April 2022 and the continued publication of Tom/Next (adjusted to become DESTR plus a fixed spread) every business day until 1 January 2026, after which time it will cease to exist.
- On 22 March 2022, the DFBF announced that the DFBF and Danmarks Nationalbank had determined a fixed spread between pre-DESTR and Tom/Next, to be calculated at 0.190%. This was based on a calculation period of 19 March 2021 – 21 March 2022.

  DFBF provides a one-off spread between DESTR and Tom/Next – DFBF
  CIBOR Redetermination 18th March 2022 – DFBF
  Upcoming changes to the CIBOR and Tom/Next benchmarks – DFBF
  DFBF17028-Post-Publication-and-Re-determination-Policy.pdf

SOFR Rates | Overview

SOFR

SOFR is a benchmark rate administered by the Federal Reserve Bank of New York (New York Fed) which has been selected to replace USD LIBOR.

SOFR itself is a backward-looking overnight rate because it is based on overnight transactions in the U.S. Treasury repo market.

The backward-looking nature of SOFR means that it is not possible to know tomorrow's SOFR – it is only possible to know the previous business day's SOFR.

SOFR in arrears

- SOFR Compounded in arrears *
- Daily Simple SOFR (Simple in arrears)
- SOFR Index

SOFR in Advance

- SOFR Average
- Term SOFR *

* The most used SOFR rates in both Europe and the US.
The other SOFR rates are observed in the fragmented US market depending on product segment. ARRC Application Examples for US business: users-guide-to-sofr2021-update.pdf (Table 5: ARRC Convention and Term Sheet Documentation)

SOFR Rates | Explanations (1/2)

- The SOFR (Secured Overnight Financing Rate) is calculated as a volume-weighted median of transaction-level tri-party repo data collected from the Bank of New York Mellon as well as GCF Repo transaction data and data on bilateral Treasury repo transactions obtained from the U.S. Department of the Treasury’s Office of Financial Research (OFR). Each business day, the New York Fed publishes the SOFR on the New York Fed website at approximately 8:00 a.m. ET for the previous day.

- With the SOFR Compounded in arrears, interest payments are determined on the basis of a compounded average of the SOFR, whereas with the Daily Simple SOFR (Simple in Arrears) no compounding takes place. Interest rate and interest payments can only be determined at the end of an interest period. The difference in interest rate determination between the two methods is minimal.

- The SOFR Index measures the cumulative impact of compounding the SOFR on a unit of investment over time. The SOFR Index value reflects the effect of compounding the SOFR each business day and allows the calculation of compounded SOFR averages over custom time periods.

- The SOFR Averages are compounded averages of the SOFR over rolling 30-, 90-, and 180-calendar day periods. The SOFR Averages for a given publication date incorporate all the SOFR values starting exactly 30-, 90-, and 180-calendar days before the publication date, regardless of whether or not that date is a weekend or holiday, and extend through the SOFR published that day. Each business day, the New York Fed publishes the SOFR Averages and SOFR Index on the New York Fed's website, shortly after the SOFR is published at approximately 8:00 a.m. ET. For SOFR Averages, the recommended convention is to 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 today.

SOFR Rates | Explanations (2/2)

- The CME Term SOFR Reference Rates benchmark is a daily set of forward-looking interest rate estimates, calculated and published for 1-month, 3-month, 6-month and 12-month tenors. A set of Volume Weighted Average Prices (VWAP) are calculated using transaction prices observed during several observation intervals throughout the trading day. Term SOFR Reference Rates will be calculated for each day the New York Federal Reserve calculates and publishes SOFR. Publication will occur at 5:00 am CT (US Central Standard Time). For Term SOFR, the recommended convention is to 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 today.

Where can I find RFR quotations without access to Bloomberg?

Rechtsordnung							
Alternativer risikofreier Zinssatz (RFR)	€STR	SONIA Overnight	Term SONIA	SOFR Overnight	Term SOFR	SARON	TONA
Veröffentlichungszeitpunkt	09:00am CET T+1	09:00am GMT T+1	11:50am GMT	08:00am ET T+1	11:15am ET	EoD fixing around 6pm CET (several fixings per day - but only EoD fixing relevant for settlements/derivatives)	10:00am JST T+1
Quotierungen	Euro short-term rate (€STR) (europa.eu)	sonia data series | Bank of England | Database Daily Sterling Overnight Index Average (SONIA) Rate (IUDSOIA) | FRED | St. Louis Fed (stlouisfed.org)	ICE Report Center - Data	Secured Overnight Financing Rate Data - FEDERAL RESERVE BANK of NEW YORK (newyorkfed.org) Secured Overnight Financing Rate (SOFR) | FRED | St. Louis Fed (stlouisfed.org)	Term SOFR - CME Group	SIX Indices - Swiss Reference Rates (SARON) (six-group.com)	Call Money Market Data (Updated every business day) (boj.or.jp)

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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