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Newsletter IBOR Reform 09/2022

Compilation by the Helaba IBOR Task Force

Last Update 7 September 2022

Foreword by Helaba IBOR Task Force

Ladies and Gentlemen,

Welcome to our third IBOR Reform Newsletter in 2022. In this issue, we have again compiled what we consider to be the most relevant developments for you in the key currency regions affected by the IBOR reform and would like to share our market observations with you. Our compilations do not claim to be exhaustive.

The new Risk Free Rate benchmarks have now entered the mainstream. Nevertheless, we observe that market standards still need to be established in certain areas. These include, for example, the handling of credit adjustment spreads in the context of refinancing. It is also still an open question what role the forward-looking Term SOFR will play in the USD LIBOR replacement.

So far, outside of the U.S., depending on the business segment, we have only seen a slight increase in demand for Term SOFR in recent weeks and months. Many customers are also still monitoring market developments. At the moment, there is no uniform use of SOFR Compounded or alternatively Term SOFR. It cannot be ruled out that preferences and market standards will emerge for individual business segments or products, not least for the transition of existing business, especially as the derivatives business is to be converted uniformly to SOFR Compounded due to market requirements.

As always, we are at your disposal for a personal exchange on market observations, for the structuring of new business on a risk free rate basis as well as for the transition 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 27 April 2022 (1/7)

- It is expected that the transition of the USD LIBOR legacy business will start market-wide in late 2022/early 2023. Legacy contracts must be converted by 30 June 2023 at the latest, the termination date of the remaining USD LIBOR rates.
- So far, it can be observed that uniform market standards still have to be established in some cases with regard to Term SOFR. Also, a uniform usage of SOFR Compounded or alternatively Term SOFR is not apparent. Only in recent weeks and months has there been a slight increase in demand for Term SOFR outside the USA, depending on the business segment. It cannot be ruled out that different preferences and market standards will emerge for individual regions, business segments or products.
- On the derivatives side, on the other hand, the requirements of the International Swaps and Derivatives Association (ISDA) stipulate a switch from USD LIBOR exclusively to SOFR Compounded. This in consequence means that hedged legacy loan business in turn can only be converted to SOFR Compounded, since otherwise economic differences arise.
- To this extent, it can be assumed that banks will only approach their customers once they can submit a transition offer that is well-founded in terms of market developments. Therefore, the focus in the coming weeks and months will increasingly be on practices for variable-rate USD new business (including refinancings). Market developments in the USA will also be monitored and the extent to which these will be decisive for business in Europe.
- We recommend to choose an active approach for the transition of USD LIBOR and possibly other IBORs still to be converted and not to rely on legal fallback regulations or synthetic benchmarks which - if at all - can only be considered as a temporary solution.

Highlights and Market Observations since 27 April 2022 (2/7)

- EONIA, the CHF/EUR/GBP/JPY LIBOR benchmarks and the 1-week and 2-month USD LIBOR rates were discontinued as of 31 December 2021. However, since then synthetic 1-, 3- and 6-month GBP und JPY LIBOR rates have been published on a temporary basis to support the remediation process of the remaining GBP and JPY LIBOR legacy business. Publication of synthetic JPY LIBOR rates is to be ceased on 31 December 2022. The British Financial Conduct Authority is seeking views in a consultation on ceasing the requirement to continue publication of the 1- and 6-month GBP LIBOR settings at the end of March 2023 instead of end-December 2022 and when it would be possible for the synthetic 3-month GBP LIBOR setting to cease in an orderly fashion. It also enquires about volumes of remaining USD LIBOR legacy business, how fast these can be transitioned depending on business type and if a synthethic USD LIBOR is required to wind down long-term legacy transactions in an orderly fashion.

  https://www.fca.org.uk/publication/consultation/cp22-11.pdf

- While the focus last year was on the first-time transition of IBOR reference rates to Risk Free Rates (RFRs), now many facilities are on the agenda for a refinancing in the coming weeks and months, that have already been whole or in part transitioned to RFR + Credit Adjustment Spread (CAS). The CAS secures the economic balance between the previous IBOR reference rate and the new RFR benchmark. The CAS rates fixed by Bloomberg continue to apply. For refinancings and new transactions that due to the cessation of IBOR reference rates directly start on RFR benchmarks it is no longer necessary to separately show a CAS, as these transactions are directly priced based on RFR benchmarks. Consequently a previous CAS will become in total or in part an element of the margin. In multicurrency facilities this could also lead to the arrangement of an individual margin per RFR based currency. The newly agreed margin not only reflects current market developments, but also pricing requirements of the previously separately listed CAS for the individual currency/currencies and interest period(s). It has to be taken into account that in some circumstances depending on the terms of the facility, the approved currencies and interest periods the range of a CAS of 1 week up to 12 months would have to be included in the pricing. For USD, for example, this range amounts to 0.72%. The question is, if it would not be easier and more transparent to continue working with a CAS, especially in those cases where a uniform margin or margin grid are to be preferred. Here, too, it will become clear in the coming months, which practice will become established in the market.

Highlights and Market Observations since 27 April 2022 (3/7)

- In its LIBOR Legacy Playbook, published on 11 July 2022, the ARRC provides an overview of the current systems in place and aims to ease the transition away from the remaining legacy LIBOR cash products, which it estimates at around USD 5 trillion. The Playbook explains the steps market participants could take to ensure successful implementation of fallbacks and it describes the LIBOR contract remediation process. The ARRC recommends the counterparties to remediate any remaining LIBOR contracts whenever feasible.

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2022/LIBOR_Legacy_Playbook.pdf

- Although, as a general principle, the ARRC recommends that market participants use overnight and averages of SOFR, it also supports the use of Term SOFR rates in areas where use of overnight and averages is more difficult. On 19 May 2022, the ARRC had announced its endorsement of CME Group 12-month Term SOFR rate for certain uses in line with its Best Practice Recommendations Related to Scope of Use of the Term Rate. The use of the 12-month CME Term SOFR rate should be primarily directed toward use as part of a fallback in legacy products that reference the 12-month LIBOR and in trade or receivables finance.

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2022/ARRC_CME_12-Month_SOFR_Term_Rate.pdf

- On 29 June 2022 the European Money Markets Institute (EMMI) published the outcome of its second annual review for the hybrid methodology for EURIBOR. As part of the review EMMI analysed a number of scenarios, based on the data gathered from the panel banks in the period May-October 2021. In the process, EMMI identified four non-material amendments (i.e. some fine tuning of eligibility criteria and formulaic approach) to the hybrid methodology for EURIBOR, that will be implemented from 3 October 2022 to improve its robustness and making it even more resistant to undue fixing influence.

  https://www.emmi-benchmarks.eu/globalassets/documents/pdf/communication/news/pr-2022.06.29-outcome-of-the-second-annual-review-of-the-methodology.pdf

Highlights and Market Observations since 27 April 2022 (4/7)

- In its bulletin dd. 20 June 2022 regarding the successful transition from EONIA to €STR according to schedule, the European Central Bank (ECB) recommended €STR as a basis for fallback rates for the eventuality of EURIBOR being discontinued. The ECB supports this by publishing compounded €STR rates, which can be used as a EURIBOR fallback.

  https://www.ecb.europa.eu/pub/economic-bulletin/articles/2022/html/ecb.ebart202204_03~782540dbd5.en.html#toc11

- Regarding the long announced fallback regulations for EURIBOR, EMMI started a consultation on its draft methodology for a forward-looking €STR Term Rate (EFTERM) on 4 July 2022. The outcome of the consultation is expected for Q4/2022. Developing the methodology EMMI took into considerations the recommendations of the Euro Risk-Free Rate Working Group and proposes that EFTERM follows a waterfall methodology, using €STR-linked OIS tradeable quotes as a first level, €STR-linked OIS dealer-to-client quotes as a second level, and €STR-linked one month futures settlement prices as the last level to fall back to.

  The forward-looking EFTERM will be designed to measure the average expected €STR rates over the tenors of 1 week and 1/3/6/12 months. ICE Benchmark Administration Limited was determined as calculation agent for EFTERM. The EFTERM rates will be published on every TARGET day at or shortly after 11:15 am (CET). Since 13 June 2022, the EMMI has been publishing sample EFTERM calculations (Beta EFTERM Rates) on its website for an initial period covering the duration of the consultation. The sample file is updated every Monday with the daily calculations from the previous week.

  https://www.emmi-benchmarks.eu/globalassets/documents/pdf/efterm/d0252a-2022---efterm-consultation-paper.pdf

- Welcomed by the ARCC, Refinitiv Benchmark Services (UK) Limited (RBSL) announced on 11 July 2022 its intention to launch forward looking term rate versions of its ARCC recommended fallback rates - USD IBOR Cash Fallbacks - in September 2022. This notice follows the ARRC's March 2021 announcement that it had selected RBSL to publish its recommended fallback rates for cash products and RBSL's November 2021 announcement that it had released production fallback rates based upon various SOFR conventions.

Highlights and Market Observations since 27 April 2022 (5/7)

USD IBOR Cash Fallbacks are intended to support a smooth transition for the immense volume of USD LIBOR legacy cash product contracts (such as loans, bonds and securitised products) referencing LIBOR and maturing after 30 June 2023, which will use the ARRC's recommended fallback rates through use of appropriate fallback language or New York and US Federal laws.

The rates will be based upon CME Term SOFR plus the ARRC's recommended spread adjustments. CME Term SOFR reference rates are administered by CME Group Benchmark Administration Limited (CBA). There are two versions of the Refinitiv USD IBOR Cash Fallbacks: one for institutional cash products, the other for consumer cash products. The term rate versions of both USD IBOR Cash Fallbacks will be available as all-in spread adjusted rates in 1/3/6/12-month tenors.

Forward looking term rate versions of USD IBOR Institutional Cash Fallbacks will be launched as production benchmarks and USD IBOR Consumer Cash Fallbacks will initially be launched as prototype rates with the intention that these rates will enter production immediately following 30 June 2023, when the ARRC's recommended spread-adjustments for consumer products will be officially set.

https://www.refinitiv.com/en/media-center/press-releases/2022/july/refinitiv-to-launch-forward-looking-term-rate-versions-of-arrc-recommended-fallback-rates

https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2022/20220711-ARRC-Press-Release-Refinitiv.pdf

- It has to be taken into account that the new Refinitiv USD IBOR Cash Fallbacks only apply to cash products whereas the derivatives market is entirely set up on using CME Term SOFR rates published by CBA. Consequently, economic differences could arise. So far, the market standard for loan and derivative contracts is based on CME Term SOFR rates plus CAS with systems market-wide being set up to work with these Term SOFR rates including associated rounding conventions.

Highlights and Market Observations since 27 April 2022 (6/7)

- On 16 May 2022, RBSL announced in its function as benchmark administrator for the Canadian Dollar Offered Rate (CDOR), that calculation and publication of the remaining 1/3/6-month CDOR rates would be permanently cease after 28 June 2024. This decision was preceded by recommendations of the Canadian Alternative Reference Rate Working Group (CARR) in December 2021 as well as a consultation in Q1/2022 regarding a possible cessation of the reference rates. The Ontario Securities Commission and the Autorité des marchés financiers had provided the relevant approvals for the cessation of CDOR before the cessation announcement.

  https://www.refinitiv.com/content/dam/marketing/en_us/documents/methodology/cdor-cessation-notice.pdf
  https://www.refinitiv.com/content/dam/marketing/en_us/documents/methodology/cdor-outcome-statement.pdf

- ISDA confirmed on 16 May 2022, that RBSL's announcement constituted a Index Cessation Event under the ISDA 2020 IBOR Fallbacks Supplement, the 2021 ISDA Interest Rate Derivatives Definitions and the ISDA 2020 IBOR Fallbacks Protocol.

  https://www.isda.org/2022/05/16/isda-statement-on-rbsl-cdor-announcement/

- Consequently, Bloomberg fixed and published corresponding spread adjustments on 16 May 2022. RBSL had already announced on 12 November 2020 the cessation for the 6- and 12-month CDOR rates starting 17 May 2021. The relevant spread adjustments had been fixed by Bloomberg on 12 November 2020 and updated on 18 August 2021.

List of impacted CDOR Fallbacks

CDOR	Tenor	Ticker	Spread Adjustment (%)
CAD	1 Month	YCDOR01 Index	0.29547%
CAD	2 Month	YCDOR02 Index	0.30190%
CAD	3 Month	YCDOR03 Index	0.32138%

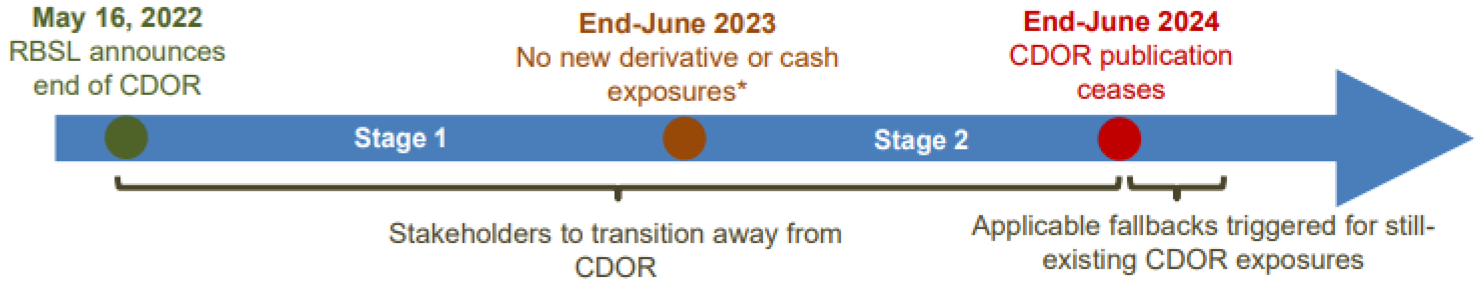
List of impacted IBOR Fallbacks

IBOR	Tenor	Old Ticker (to be deprecated)	New Ticker	Old Spread Adjustment (%)	Revised Spread Adjustment (%)
CAD CDOR	6 Months	SCDOR06 Index	YCDOR06M Index	0.49323	0.49375
CAD CDOR	12 Months	SCDOR12 Index	YCDOR1Y Index	0.54790	0.54820

- https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks_CDOR_Cessation_Technical-Note_220516.pdf
- https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-CDOR-Tenor-Cessation-Annoucement-11-17-2020.pdf
- https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks_CDOR_Spread_Adjustment_Amendment.pdf

Highlights and Market Observations since 27 April 2022 (7/7)

- It is planned to transition from CDOR to the backward-looking RFR Canadian Overnight Repo Rate Average (CORRA) in 2 stages:
  - Stage 1: By the end of June 2023 all market participants are expected to transition new derivative (bilateral, cleared and exchanged-traded) and securities contracts or transactions from CDOR to overnight CORRA in arrears. No new CDOR exposure will be booked after that date with limited exceptions. Those exceptions include derivatives that hedge or reduce CDOR exposures of derivatives or securities transacted before 30 June 2023 or in loan agreements transacted through until 28 June 2024.
  - Stage 2: Market participants would be allowed to continue to transact in new CDOR based loans, with robust CDOR fallbacks, until the cessation of CDOR after 28 June 2024. Market participants can continue to hedge CDOR based loans with CDOR based derivatives until this end date. Market participants can choose to transition their loan facilities to reference CORRA in-arrears, Term CORRA or any other alternative rate that is available at any point during this transition period.



CARR is determining in the context of a consultation, if demand exists for certain products respectively types of loan agreements for a forward-looking 1- and 3-mont Term CORRA benchmark. The result is pending.

https://www.bankofcanada.ca/wp-content/uploads/2022/05/transition-roadmap.pdf

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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