05.11.2020

Libor is changing

Interbank Offered Rates (IBORs) are expected to be replaced by new Alternative Reference Rates (ARRs) across the global financial markets. The Financial Conduct Authority (FCA), global regulators and other industry organisations expect that the London Interbank Offered Rate (LIBOR), as well as other frequently used IBORs, will no longer be credible interest rate benchmarks after the end of 2021. Work is underway for the replacement of LIBOR and other global IBORs to ARRs. Given the complexity of these changes, it is important that you understand what the transition entails and what actions you should consider taking to prepare for the transition.

What is Libor?

LIBOR is a widely accepted interest rate benchmark and is used to calculate interest rates or other payments in a broad range of financial products, such as loans, bonds and derivatives and is used as the basis for valuations by market participants, both in the UK and abroad. It is also used for banks and other financial institutions own funding and capital needs.

Why is Libor being replaced?

Global regulators and industry organisations have expressed concerns with the use of LIBOR (and other IBORS) stating that the underlying market which LIBOR measures is no longer active or sufficiently liquid. As LIBOR is calculated based on submissions from selected panel banks, the problems with the underlying markets mean that LIBOR rates are not representative and in some instances based on expert judgement rather than actual transactional data. A key objective of the transition is the creation of an interest rate market based on actual transactions leading to a more transparent, reliable and representative interest rate market.

What are ARRs?

ARRs have been chosen by regulators to replace LIBOR and other IBORs. They are perceived as risk free and based on actual lending transactions with high volumes, and as such, are highly representative of the actual market rather than expert judgement.

What is SONIA and what are the benefits?

The current preferred ARR to replace LIBOR in the sterling bond, loan and derivatives markets is the Sterling Overnight Index Average (**SONIA**) benchmark. SONIA is perceived by regulators and industry bodies as being a robust alternative to LIBOR. In particular, SONIA is:

- based on overnight interest rates in wholesale markets so is close to a risk-free measure of borrowing costs;
- robust and anchored to an active and liquid underlying market; compounded over a lending period to produce a term interest rate; and
- provides many advantages to borrowers and investors.

What approach are other countries taking?

Similar transitions for other IBORS are taking place across the world, and working groups in a number of jurisdictions have identified replacement benchmarks.

Currency	IBOR	Proposed ARR	Working Group
Euro	EUR LIBOR EONIA	Euro Short Term Rate (€STR)	Working Group on Euro Risk-Free Rates
US Dollar	USD LIBOR	Secured Overnight Financing Rate (SOFR)	Alternative Reference Rates Committee
Japanese Yen	JPY LIBOR TIBOR	Tokyo Overnight Average Rate (TONA)	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks
Swiss Franc	CHF LIBOR	Swiss Average Rate Overnight (SARON)	National Working Group on Swiss Franc Reference Rates
Hong Kong Dollars	HIBOR	Hong Kong Dollar Overnight Index Average (HONIA)	Treasury Markets Association
Singapore Dollars	SIBOR	Singapore Overnight Rate Average (SORA)	Association of Banks in Singapore and the Singapore Foreign Exchange Market Committee
	SOR		
Canadian Dollar	CDOR	Canadian Overnight Repo Rate Average (CORRA)*	Bank of Canada's Canadian Alternative Reference Rate Working Group
Australian Dollar	BBSW	RBA Interbank Overnight Cash Rate (AONIA)*	The IBOR Transformation Australian Working Group

* Canada is adopting a multi-rate approach with both CDOR and CORRA co-existing as interest rate benchmarks.
**BBSW will still be maintained as the credit-based benchmark for the Australian Dollar.

What are the timeframes with the UK LIBOR transition?

The FCA has stated that it will not require banks to submit to LIBOR after the end of 2021. The FCA and the Bank of England have reconfirmed that firms cannot rely on LIBOR being published after the end of 2021.

The Working Group on Sterling Risk-Free Reference Rates, working with the FCA and Bank of England, recommended that:

- By the end of Q3 2020 lenders should be in a position to offer non-LIBOR linked products to their customers;
- After the end of Q3 2020 lenders, working with their borrowers, should include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion ahead of end-2021, through pre-agreed conversion terms or an agreed process for renegotiation, to SONIA or other alternatives; and
- All new issuance of sterling LIBOR-referencing loan products that expire after the end of 2021 should cease by the end of Q1 2021.

What should customers be aware of now?

If you have any existing contracts with ISBANK London, or enter into any new ones, that reference LIBOR, you should be aware of the following:

- It is expected that LIBOR will cease to be published and that it will be necessary to determine an ARR. It is important to note that ARRs currently identified by the relevant industry bodies behave differently from LIBOR in many respects;
- The reform of some IBORs may result in different calculation methodologies and different performances than in the past;
- Your financial contracts may already include fallback provisions that may provide an alternative mechanism for when LIBOR ceases to be published. Alternatively, financial contracts referencing IBORs (in particular those linked to LIBOR) may require adjustment to incorporate necessary fallback provisions (i.e. contractual provisions for ARRs instead of the IBORs in question) and any other appropriate amendments such as spread adjustments;
- The occurrence of any of the above may: (1) materially impact the economic value of the relevant financial transactions (for example, the value of certain financial products that you may hold), and (2) result in a mismatch between the rate referenced in the relevant financial instrument and your other financial instruments, including potentially those that are intended as hedges. It may also cause accounting or tax issues or have other unforeseen or adverse consequences for you.

The above list only highlights some of the risks and should not be treated as an exhaustive list.

What is ISBANK London's approach to the transition?

We are closely monitoring developments. We are assessing impacts and seeking to mitigate risks and will continue to engage with our customers on market developments and on the potential risks and implications that the LIBOR transition may have on the financial products that you currently have with ISBANK London.

What should customers be doing now?

Customers should conduct their own independent investigation and analysis of the potential consequences of any relevant risks, including potential market, financial, legal, accounting, tax, and regulatory impacts on financial contracts and transactions.

ISBANK London will continue to engage with its customers on market developments and on the potential risks and implications that the transition may have on the financial products you currently have with ISBANK London.

More information

We will update this page and provide communications relating to the changes as appropriate. In the meantime, if you require any further information, please contact your Relationship Manager or email us on corporate@isbank.co.uk.

You can also find further information on the FCA and Bank of England's websites, as well as the websites of the working groups and industry bodies that are considering these issues.