

COMMERCIAL BANKING**TRANSITION MOMENTUM INCREASES**

Welcome to our Newsletter. This is our sixteenth edition providing an update on the transition away from the London Interbank Offered Rate (LIBOR) and other Interbank Offered Rates (IBORs). There are a number of important topics this month, which include:

- **KEY PRIORITIES FOR STERLING MARKETS**
- **MORE SUPPORT FOR STERLING TRANSITION**
- **FOCUS ON NON-LINEAR DERIVATIVES**
- **NEW FORMS FROM THE LMA**
- **LCH CONFIRMS CONVERSION DATES**
- **US DOLLAR ACTIVITIES ACCELERATE**
- **A CLOSER LOOK: TERM RISK FREE RATES**

Please contact your Relationship Team if you have any questions or queries on the contents.

KEY PRIORITIES FOR STERLING

Following the Financial Conduct Authority's (FCA) early March 2021 formal announcement of the cessation dates for LIBOR, the sterling markets reached another key milestone on 1 April 2021: to stop using sterling LIBOR in new lending and linear derivatives (e.g. swaps) that mature after the end of 2021. News and developments over the past month, however, only help to highlight that these recent milestones represent only the beginning, rather than the end, of what needs to be done before the end of the year.

This sentiment was reflected in a [joint letter](#) from the UK Prudential Regulation Authority (PRA) and the FCA to CEOs of supervised firms on 26 March 2021, which set out the supervisory expectations of the transition from LIBOR to risk-free rates (RFRs). The letter reinforces that regulators expect all firms to meet the Bank of England Working Group on Sterling Risk-Free Reference Rates (BoE WG) upcoming milestones and the targets from other working groups as appropriate.

The BoE WG [roadmap](#) emphasises that all legacy sterling LIBOR contracts expiring after end-2021 need to be actively converted or have robust fallbacks in place before the end of September this year.

MORE SUPPORT FOR STERLING TRANSITION

To assist in meeting upcoming milestones, the BoE WG has issued a number of new supporting materials. It published a [statement](#) on 23 April 2021, which sets out a range of considerations intended to help market participants across GBP bond, loan and derivative markets, assess and prioritise the active transition of legacy GBP LIBOR contracts to SONIA. On the same day, the BoE WG [provided](#) a paper aimed at market participants who may wish to rely on ISDA's fallbacks providing a number of infrastructure and operational considerations to inform their planning and preparation for the operationalisation of fallbacks in non-cleared linear GBP LIBOR derivatives.

These materials, followed the release of a [paper](#) on 19 April 2021, detailing some key considerations for new issuance in structured products referencing compounded in arrears SONIA, as well as providing some high-level views to support the transition of legacy GBP LIBOR structured products. The paper is intended to assist issuers, manufacturers, distributors and investors in their transition plans.

NON-LINEAR DERIVATIVES IN FOCUS

One major BoE WG milestone on the horizon is the requirement for supervised entities to cease initiating any new sterling LIBOR-linked non-linear derivatives that expire after 2021 by the end of Q2-2021 – except in those situations where it is required for risk management of existing positions. In a supporting move to encourage sufficient market liquidity to meet this milestone, the Bank of England (BoE) and FCA issued a joint [statement](#) of support on 29 March 2021, directing market makers in the sterling non-linear derivatives market to adopt new quoting conventions for inter-dealer trading based on SONIA from 11 May 2021.

NEW FORMS FROM THE LMA

It is well understood that more than just regulatory initiatives are required to achieve transition – the support of market bodies and industry groups, like the Loan Market Association (LMA), remain key pillars of success. The LMA, in order to help accelerate further transition activity in the syndicated loan space, on 29 March [published](#) a set of recommended forms of templates for loan agreements which reference RFRs, which amongst other items, includes the most recent updates to the BoE WG's [supporting material](#) on detailed loan conventions. The suite of material includes updates to the notes outlining LIBOR transition considerations for the LMA's wider suite of documentation.

LCH CONVERSION DATES

Meanwhile, following an announcement in February 2021 that it would run a LIBOR conversion event, the London Clearing House (LCH) [published](#) supplementary information including the proposed dates of Friday 3 December 2021 for CHF, EUR & JPY LIBOR and Friday 17 December 2021 for GBP LIBOR.

US DOLLAR ACTIVITIES ACCELERATE

The US Alternative Reference Rates Committee (ARRC) has set a key milestone to end new US dollar LIBOR activity at the end of the year and has recently made a series of announcements to support transition efforts in US dollar lending markets. On 17 March 2021, the ARRC [announced](#) that it has selected Refinitiv to publish the ARRC recommended spread adjustments and spread adjustment rates. This will make these rates readily accessible on a daily basis to the public, free of charge. It also [published](#) a white paper on 29 March 2021, promoting use of the Secured Overnight Financing Rate (SOFR) in asset-backed securities. In addition, on 7 April 2021, the ARRC provided an [endorsement](#) of the signing of new LIBOR legislation into New York State law which addresses the issues of legacy contracts referencing US dollar LIBOR that mature after mid-2023 and do not have effective fallbacks.

In similar fashion to regulators in the UK, the Federal Reserve Board (FRB) on 9 March 2021 [published](#) guidance for examiners in assessing supervised firms' LIBOR transition progress. The guidance directs examiners to consider issuing supervisory findings and other supervisory actions for firms that are not prepared to stop using LIBOR by 31 December 2021.

A more in-depth look at the progress of US dollar LIBOR transition, up to 31 March 2021 is provided by the ARRC's latest [Progress Report](#), which ends with an outline of some of the key steps ahead.

A CLOSER LOOK: TERM RISK FREE RATES

Term RFRs have received some attention in recent weeks. In the case of the US dollar, the ARRC has issued a [statement](#) that contrary to its previous objective it will not be in a position to recommend a forward-looking SOFR, commonly referred to as Term SOFR, by the middle of 2021. The basis for the decision was lack of liquidity in the SOFR derivatives market to formulate a sound term rate and the need to further evaluate the anticipated limited scope of use for Term SOFR.

Nevertheless, the ARRC did [provide](#) on 20 April 2021, the key principles that it believes are necessary to recommend a forward looking SOFR term rate. On the following day the Chicago Mercantile Exchange Group (CME), [announced](#) that it is publishing Term SOFR reference rates for 1-month, 3-month and 6-month tenors for the time being on an unendorsed basis.

In terms of sterling, FTSE Russell has decided to [discontinue](#) their production of Term Sterling Overnight Index Average (SONIA); this now leaves ICE Benchmark Administration (IBA) and Refinitiv as the sole providers in this space.

Term RFRs, such as Term SONIA are being developed because the underlying RFR rates are just overnight rates – reflecting the interest rate for a particular day only. Term RFRs, on the other hand, reflect the expected average rate of a designated risk-free rate over a given future period in similar fashion to e.g. 3 month LIBOR. However, unlike LIBOR, the RFR term rates cannot be based on actual transactions as SONIA, SOFR and other RFRs are overnight rates. Nor by design, do they reflect term bank credit risk like LIBOR. For more information on the topic from the BoE WG please see [here](#).

So, although term RFRs might at face value appear like an apparently perfect like-for-like substitute for LIBOR in terms of forward rate calculation, there are a number of challenges to them being used as a robust alternative both in US dollar and sterling markets.

Hence the FCA has stated that 'the use of these forward-looking rates is meant to be limited' and the BoE WG has recommended that in the majority of cases SONIA compounded in arrears is the replacement rate for LIBOR. Term SONIA is only recommended for very limited use in trade, working capital, and Islamic financing situations.

More recently the FICC Markets Standards Board (FMSB) has [published](#) a proposed standard on use cases for Term SONIA rates in sterling markets, which also highlights some of the challenges related to term rates, inviting comments on the proposals by 28 May 2021. This was [welcomed](#) by the BoE, FCA and BoE WG.

Just like with Term SONIA, the ARRC in the US envisages a similar limited use case for Term SOFR. Equally, the ARRC encourages market participants not wait for a term rate and to make use of the simple or compounded SOFR conventions currently available. In turn, the ARRC has recommended a number of actions aimed at building liquidity in SOFR derivatives that would help support the robustness of any recommended term rate.

Still, the delay of an official sector, fully endorsed solution for Term SOFR will have implications for trade & working capital products in terms of when and onto what these will transition before the end of the year, as a large percentage of the market currently relies on US dollar LIBOR.



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