BANK OF SCOTLAND

IBOR TRANSITION NEWSLETTER

Seventh Edition: June 2020

COMMERCIAL BANKING

Welcome to our seventh Newsletter, which provides an update on the transition away from LIBOR and other Interbank Offered Rates (IBORs). With 2021 fast approaching, this Newsletter aims to raise awareness of key developments on an ongoing basis. We will continue to send this newsletter to you regularly during the period of transition. We hope you will find it helpful.

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

What has happened recently

No major new COVID-19 related delays to interim milestones were announced in June. Instead, the PRA and FCA restored full supervisory engagement with LIBOR transition after a period of hiatus due to COVID-19. Focus simultaneously fell back to some of the key priorities outlined by both the FCA and Bank of England back in April. More specifically, the Working Group on Sterling Risk-Free Reference Rates (BoE WG) published a paper on the identification of "tough legacy" contracts being those that do not have robust fall backs and prove unable to be amended ahead of LIBOR discontinuation.

The BoE WG paper highlights that "tough Legacy" characteristics vary across asset classes/transaction types. For example there are scenarios where 1) contracts form part of complex transactions or arrangements; 2) distribution is broad and there may be additional complications with obtaining the necessary consent; and 3) retail counterparties are involved. The paper goes on to propose that the UK consider legislative proposals in relation to “tough legacy” contracts, but recognises that there is no guarantee that a legislative solution will materialise and that any such potential solution may not be economically neutral or suitable for certain contracts. Other solutions to the tough legacy problem should be pursued in parallel, such as LIBOR being stabilised via a so called ‘synthetic methodology’. Furthermore, the overarching view is that firms should continue to proactively remove LIBOR dependencies from their contracts before the end of 2021. The paper provides another step toward bridging the issues created by “tough legacy” contracts.

Separately, the International Swaps and Derivatives Association (ISDA) published a new fact sheet entitled "Understanding IBOR Fallbacks" explaining what the individual fallbacks are and why they are necessary. Fallbacks are the replacement rate that would apply to trades referencing a benchmark. These will take effect if the relevant benchmark becomes unavailable while market participants continue to have exposure to that rate. Likewise, for derivatives that only reference LIBOR, the fallback will take effect following a determination by the FCA that LIBOR in the respective currency is no longer representative of its underlying market, even if it continues to be published.

As a reminder, ISDA are due to publish a supplement to the 2006 ISDA definitions in July to incorporate new fallbacks for derivatives that reference certain key IBORs, together with a protocol that will allow market participants the choice to incorporate the revisions into their legacy trades. Given fallbacks in cash products are also under consideration, the factsheet is an equally worthwhile reference material for those without derivatives contracts.

In addition to the ISDA reference materials, the Alternative Reference Rates Committee (ARRC) in the US updated its Frequently Asked Questions to provide further clarity on how the COVID-19 pandemic influences LIBOR transition. The new addition reaffirms the ARRC’s commitment to the end of 2021 deadline for transition. Aside from the COVID-19 update, the Frequently Asked Questions continue to provide an invaluable resource for information on USD LIBOR and broader transition.

The FICC Markets Standard Board (FMSB) report titled "LIBOR transition: Case studies for navigating conduct risk" was another document to be made available. As a guide to conduct around transition, the report provides good practical case studies to support firms when considering the risks to fairness and effectiveness as the market moves to risk-free rates as more sustainable and representative benchmarks. Notwithstanding being written with financial firms in mind, the case studies outlined in the report should prove equally helpful to commercial banking clients.

Besides new reference materials, a published summary of responses to a BoE consultation showed near-unanimous support for the provision of a compounded SONIA index. Similarly, the report noted that there was a high degree of support for the proposed methodology, which was viewed to promote international consistency. Looking ahead, the BoE expects to begin publication of the index sometime in early August. The BoE also confirmed that there are no plans at this stage to produce any additional indices or data.

A closer look

IBOR transition in CHF, JPY, and EUR

Many of the developments discussed over recent months have been about USD and GBP LIBOR, but the effort to move away from interbank overnight lending rates (IBORs) is international. The path towards transition, however, is not consistent amongst the remaining three less mentioned active LIBOR benchmarks. Deadlines differ, as do the processes and the types of benchmarks proposed, despite a shared commitment from regulators to cease LIBOR by the end of 2021.

In the case of CHF LIBOR, the situation closely resembles that for USD and GBP. Swiss authorities remain fully committed to LIBOR cessation. A risk-free reference rate called the Swiss Average Rate Overnight (SARON) has been established and a compounding approach is being adopted. FINMA, the Swiss regulator, expects substantial progress on replacing CHF LIBOR-based cash products with those SARON based by the end of 2020. In terms of derivatives, SARON is to be documented by ISDA as the recommended risk-free rate under a fallback scenario.

For JPY LIBOR, transition takes a multiple rate approach. JPY LIBOR is anticipated to cease, but a reformed Tokyo Interbank Overnight Rate (TIBOR) will stay in place. This is in tandem with the Tokyo Overnight Average rate (TONA), the recommended risk-free rate for JPY. TONA has been referenced by ISDA as the standardised risk-free rate under fallback scenarios involving both TIBOR and JPY LIBOR. Prototype risk-free term rates began publication in May and their further development is a priority. Meanwhile, in its June Dear CEO letter, the Bank of Japan requested major financial institutions submit targets for the termination of new issuance and contracts referencing LIBOR beyond 2021 by July 2020.

Preparations for the end of EURO LIBOR are also underway. As with JPY, the reformed Euro Interbank Overnight Rate (EURIBOR) will be run in parallel with a risk-free rate – the euro short-term rate (€SSTR). €STR was launched in October 2019 and reflects the daily wholesale euro unsecured overnight borrowing costs of euro area banks. As EURIBOR will remain in place, the near-term priority is to fully replace the previous risk-free benchmark - the Euro Overnight Index Average (EONIA) - with €STR. The ISDA recommended fallback rate for both EURO LIBOR and EURIBOR is €SSTR. Early 2021 will see continued consultations on how to best handle €STR fallback mechanics for cash products.

The one common theme between both JPY and EUR LIBOR transition, is although IBORs will still be in place, work to ensure appropriate fallbacks referencing risk-free rates is a major priority ahead of the end-of-2021 deadline for the cessation of LIBOR. As a result, clients with related currency exposures will still need to familiarise themselves with how risk-free rates will be used in the future even if they are not transitioning to a new rate immediately.

Forthcoming joint event with ACT

Lloyds Bank will be co-hosting a webinar with the Association of Corporate Treasurers (ACT) on 1 July at 12:30. Speakers from Lloyds Bank will discuss recent transition developments during the COVID-19 crisis and products available to support the move away from LIBOR. Shaun Kennedy, Treasurer from Associated British Ports will also share his thoughts on transition and there will be time available for Q&A. If interested, please don't hesitate to register now.

For additional information from Lloyds Banking Group on the transition from LIBOR, please see our website which includes our 'LIBOR: the countdown to 2021' paper and latest reference materials here:

Click here to visit our website >

Please let your Relationship Manager know if you have any feedback or suggestions.

Yours sincerely

Cris Kinrade
IBOR Transition Programme
Bank of Scotland Commercial Banking

DISCLAIMER

This communication, its contents and any related communication (“this communication”) was prepared by Bank of Scotland (for the purposes of this notice “Bank of Scotland” means Lloyds Banking Group plc, its subsidiaries and any of its group companies). This communication (1) shall not be relied on in connection with or be construed as a contract or commitment and shall not form the basis of or be relied on in connection with any transaction, contract or communication whatsoever; (2) is for information purposes only and is not intended to form and should not form the basis of any investment decision; (3) is not and may not be treated as investment research, a recommendation, an opinion or advice of any kind (including without limitation legal, compliance, financial, accounting and/or taxation); (4) is subject to the copyright of Bank of Scotland; (5) is based on current public information and is in summary form and, therefore, may not be complete; and (6) may only be accessed by recipients lawfully entitled to do so. By receiving this communication, you agree to its contents and requirements.

Bank of Scotland has exercised reasonable care in its preparation, but no representation or warranty is made by Bank of Scotland, and its or their directors, officers, employees, associates and agents (together the “Bank of Scotland Persons”) as to the accuracy, suitability, fairness, adequacy, correctness or completeness of the information or opinions herein. In particular, no Bank of Scotland Person is, and none should be considered to be, giving an accounting opinion or advice and you should conduct your own independent enquiries and obtain independent professional advice. Any transaction which you may enter into with Bank of Scotland will be on the basis that you have made your own independent evaluations, without reliance on Bank of Scotland, and based on your own knowledge and experience and any professional advice which you may have sought in relation to all aspects of the transaction including without limitation legal, compliance, financial, accounting and/or taxation advice. You will not use this communication to the detriment of any Bank of Scotland Persons.

No Bank of Scotland Person is acting as a fiduciary in relation to you. Bank of Scotland Persons and their clients (i) may engage in transactions in a manner inconsistent with any statement or opinion in this communication; (ii) may trade as principal in securities and/or assets and/or derivatives and/or any other financial products. Information may be available to Bank of Scotland Persons which is not reflected in this communication. Bank of Scotland may have a perceived or actual conflict of interest in relation to the matters referred to in the communication. Bank of Scotland has internal systems, controls and procedures to ensure that conflicts of interest are identified and appropriately managed.

This communication is current at the date of publication and the content is subject to change without notice. Information and opinions herein have not been independently verified or reviewed, and Bank of Scotland is not obliged to update or correct this communication. This communication may contain forward-looking statements or refer to future events or results not within the control of Lloyds Bank Persons. No representation or warranty is made as to the correctness of any forward-looking statement or whether any such event or result will occur. To the fullest extent permitted by applicable law and regulation, no Lloyds Bank Person accepts any responsibility for and shall have no liability for any loss (including without limitation direct, indirect, consequential and loss of profit), damages, or for any liability to a third party however arising in relation to this communication (including without limitation in relation to any projection, analysis, assumption and opinion in this communication). In no circumstances will any Lloyds Bank Persons be responsible for any costs, taxes or expenses incurred by any recipient in connection with any investigation of this communication or any subsequent transaction.

No Bank of Scotland Person provides legal, compliance, financial, tax, professional, regulatory or accounting advice. Accordingly, any statements contained in this communication on tax matters were neither written nor intended to be used, and cannot be used by any taxpayer, for the purpose of avoiding tax penalties that may be imposed on such taxpayer.

Bank of Scotland Persons may participate in benchmarks in any one or more of the following capacities: as administrator, submitter or user. Benchmarks may be referenced by Bank of Scotland Persons for internal purposes or products, services or transactions provided to or engaged in with you. More information is found in the Benchmark Transparency Statement on our website.

Bank of Scotland is a trading name of Lloyds Bank plc, Bank of Scotland plc and Lloyds Bank Corporate Markets plc. Bank of Scotland plc. Registered Office: 25 Gresham Street, London EC2V 7HN. Registered in England and Wales no. 2065. Bank of Scotland plc. Registered Office: The Mound, Edinburgh EH1 1YZ. Registered in Scotland no. SC327000. Lloyds Bank Corporate Markets plc. Registered office 25 Gresham Street, London EC2V 7HN. Registered in England and Wales no. 10399850. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority under registration numbers 119278, 169628 and 763256 respectively.

Please seek independent financial and legal advice if you have any questions about any of the issues raised in this communication