IBOR TRANSITION NEWSLETTER

Edition 10: September 2020

COMMERCIAL BANKING

PAVING THE WAY TOWARDS TRANSITION

Welcome to our new look Newsletter. This is our tenth edition, and it provides an update on the transition away from LIBOR and other Interbank Offered Rates (IBORs). With the end of 2021 fast approaching, these newsletters aim to raise awareness of key developments on an ongoing basis. The key topics for this month are:

- **NEW CONVENTIONS FOR SONIA LOANS**
- **UPDATED ARRC RECOMMENDATIONS**
- **CFTC LENDS SUPPORT**
- **ISDA COMPLETES WORK ON IBOR REFORM**
- **A CLOSER LOOK: THE TRANSITION TIMELINE**

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

NEW CONVENTIONS FOR SONIA LOANS

New recommendations in September are paving the way towards transition and achieving the interim milestones being set by regulators and industry. The Bank of England-initiated Working Group on Sterling Risk Free Reference Rates (BoE WG) has released recommendations on conventions to use in new sterling loans using Sterling Overnight Index Average (SONIA) compounded in arrears. The core recommendation is to use SONIA compounded over the interest period with a five day lookback which is in line with the approach recommended by the Alternative Reference Rates Committee (ARRC) for US dollar loan markets.

Other points from the BoE WG address the necessity (when applicable) for a floor on each daily interest rate before compounding, and in the event of early repayment that accrued interest should be paid at the same time as the repayment of principal. To help guide users the BoE WG also released a set of supporting slides and a series of worked examples.

In addition, for existing business referencing GBP LIBOR, the BoE WG has recommended the use of the historical five-year median adjustment methodology when calculating the credit adjustment spread to apply to SONIA when updating fallback provisions. The BoE WG also published papers to support firms in the active transition of legacy loan products and conversion of existing bonds.

UPDATED ARRC RECOMMENDATIONS

In late August the ARRC released updated recommended contractual fallback language for new *bilateral* US dollar LIBOR business loans, adjusting the language that was released in May 2019. This complements the recent revisions made to the recommended fallback language for new *syndicated* US dollar LIBOR business loans which are supported by a technical reference document covering the various conventions such as look back and observation shift that have been considered by the ARRC.

CFTC LENDS SUPPORT

The Commodities Futures Trading Commission (CFTC) announced in late August that the Division of Swap Dealer and Intermediary Oversight, the Division of Market Oversight, and the Division of Clearing and Risk have issued updated no-action letters providing relief to swap dealers and other market participants when transitioning from swaps referencing LIBOR and other interbank offered rates to reference alternative benchmarks.

This removes a potential regulatory obstacle to the adoption of the ISDA Protocols which update contracts to include robust fallback procedures in the event that an IBOR ceases or becomes non-representative. This will also assist market participants as the clearing-houses implement their planned transition of discount rates towards new reference rates, another vital step in moving the derivatives markets away from IBORs.

In support of this change, in early September the ARRC submitted a request to the US Internal Revenue Service and the US Treasury asking for clarification on the regulations being developed to reduce any tax uncertainty, and released an addendum to its recommendations on the voluntary exchange of cash compensation taking place between counterparties to legacy swaptions referencing US dollar LIBOR to avoid an extended period of uncertainty and pre-empt potential disputes.

IASB COMPLETES WORK ON IBOR REFORM

At the end of August, the International Accounting Standards Board (IASB) finalised its response to the ongoing reform of IBORs and other interest rate benchmarks by issuing a package of amendments to IFRS Standards. The amendments are aimed at helping companies to provide investors with useful information about the effects of the reform on those companies' financial statements. More specifically, these amendments address issues that might affect financial reporting, including the effects of changes to contractual cash flows or hedging relationships where an interest rate benchmark is replaced.

A CLOSER LOOK: THE TRANSITION TIMELINE

Over the last few months there have been a number of updates to offcial sector timelines. Whilst LIBOR is still expected to cease at the end of 2021, some of the interim timelines have changed. We summarise some of the key dates below:

BoE WG KEY GBP MILESTONES

- **October 2020:** lenders to be able to offer non-LIBOR alternatives to customers. New and re-financed LIBOR loan products maturing after 2021 must include contractual arrangements to facilitate conversion to SONIA or other alternatives.
- **January 2021:** progress to be made on active conversion of cash products to reduce legacy volumes where possible.
- **April 2021:** supervised entities to cease issuance of new sterling LIBOR-linked linear derivatives and cash products that mature after the end of 2021. Supervised entities are to complete an assessment of all post-2021 maturing cash contracts to identify those that can be actively converted.
- **September 2021:** work to assess and actively convert LIBOR-linked linear derivatives where viable to be completed. Supervised entities should cease new issuance of sterling LIBOR-linked non-linear and cross-currency derivatives that mature after 2021. Active conversion of cash products should be complete, and where this is not possible ensure robust fallbacks area adopted.

ARRC KEY USD MILESTONES

- **October 2020:** new Business loans should include ARRC-recommended hardwired fallback language; vendors should be ready to support SOFR.
- **April 2021:** dealers should change market convention for quoting derivatives from LIBOR to SOFR.
- **July 2021:** no new LIBOR business loans or derivative trades that increase LIBOR risk.
- **End 2021:** LIBOR expected to cease.

ISDA KEY DATES

- **September 2020** (or later date after receipt of a positive Business Review Letter from the US DoJ and similar comfort from other relevant competition law authorities): launch of amendments to the 2006 ISDA definitions and related protocol with 2-4 weeks' notice of launch date.
- **Late 2020** (or 3-4 months after publication): effective date of amendments to the 2006 ISDA Definitions and related proto-col.

For further details on key regulatory and industry timelines please see the BoE WG updated roadmap, the ARRC best practices guidelines and the ISDA website.

Cris Kinrade
IBOR Transition Programme
Bank of Scotland Commercial Banking

Live Broadcast: How prepared are you for IBOR Transition?

19th October 2:00pm – 3:00pm.

Hosted by broadcast journalist **Bridgid Nzekwu**, join to hear our speakers discuss their own experiences and address some of the challenges that businesses need to face into.

- **Heather Pilley**, Benchmarks Policy Manager, Financial Conduct Authority
- **Natasha Vowles,** Head of Treasury – Funding, Tesco
- **Ian Fox**, Group IBOR Transition Director, Lloyds Bank Commercial Banking
- **Gaj Mahadevan**, Economics and Market Insight Strategist, Lloyds Bank Commercial Banking

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