LIBOR Lowdown - Developments in Benchmark Replacement

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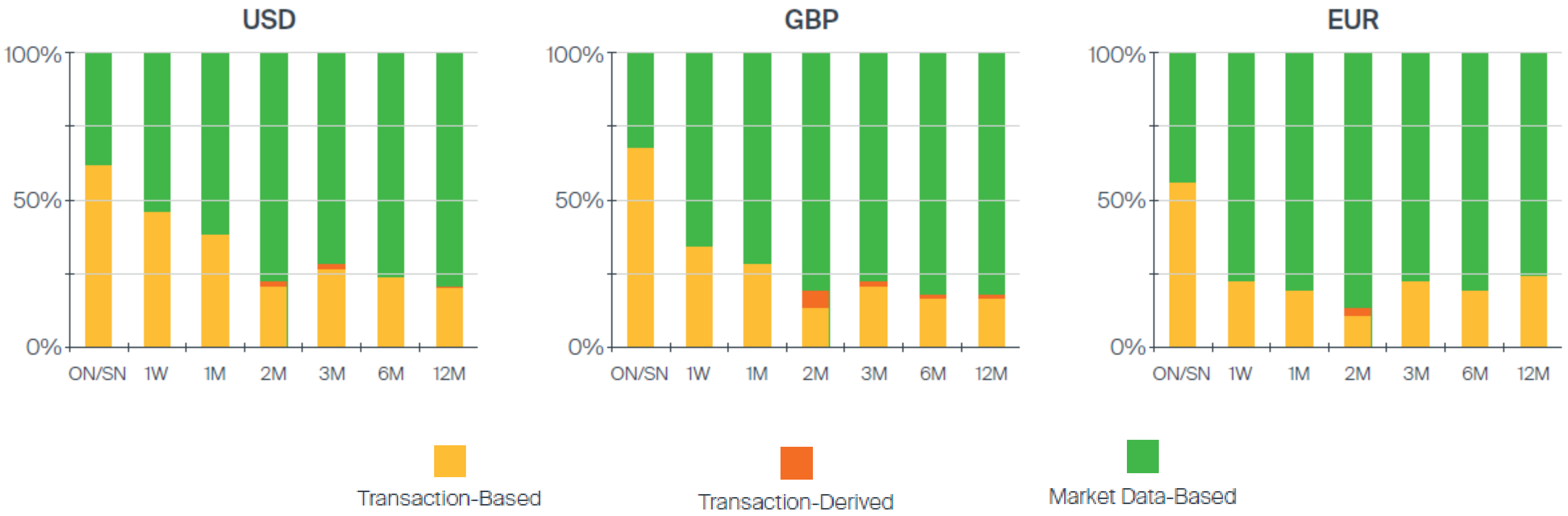
LIBOR – Why is it going away?

Report of the proportion of Panel Bank submissions used to calculate published LIBOR using the existing methodology that were Transaction-Based, Transaction-Derived or Market Data-Based for the period September 15, 2017 to December 15, 2017.



Source: ICE LIBOR Evolution, 25 April 2018

LIBOR alternatives – Risk Free Rates (RFRs)

Jurisdiction	Working Group	Alternative RFR	Rate administration	Characteristics		
				Secured vs. unsecured	Anticipated publication date / time	Description
UK	Working Group on Sterling Risk- Free Reference Rates	Reformed Sterling Overnight Index Average (SONIA)	Bank of England	Unsecured	09:00 GMT *T+1*	• Fully transaction-based • Encompasses a robust underlying market • Overnight, nearly risk-free reference rate • Includes an expanded scope of transactions to incorporate overnight unsecured transactions negotiated bilaterally and those arranged with brokers • Includes a volume-weighted trimmed mean
US	Alternative Reference Rates Committee	Secured Overnight Financing Rate (SOFR)	Federal Reserve Bank of New York	Secured	Published since 3 April 2018 08:00 ET *T+1*	• Fully transaction-based • Encompasses a robust underlying market • Overnight, nearly risk-free reference rate that correlates closely with other money market rates • Covers multiple repo market segments, allowing for future market evolution
Europe	Working Group on Risk-Free Reference Rates for the Euro Area	Euro Short-Term Rate (ESTER)	European Central Bank	Unsecured	By October 2019 09:00 CET *T+1*	• Fully transaction-based • Reflects the wholesale euro unsecured overnight borrowing costs of euro area banks
Switzerland	The National Working Group on CHF Reference Rates	Swiss Average Rate Overnight (SARON)	SIX Swiss Exchange	Secured	Currently being published 12:00, 16:00 and 18:00 CET *same day*	• Became the reference interbank overnight repo on 25 August 2009 • Secured rate that reflects interest paid on interbank overnight repo
Japan	Study Group on Risk-Free Reference Rates	Tokyo Overnight Average Rate (TONA)	Bank of Japan	Unsecured	Currently being published 10:00 JST *T+1*	• Fully transaction-based benchmark for the robust uncollateralized overnight call rate market • The Bank of Japan calculates and publishes the rate on a daily basis, using information provided by money market brokers known as Tanshi • As an average, weighted by the volume of transactions corresponding to the rate

The US Alternative Reference Rates Committee (ARRC 2.0)

- In March 2018 ARRC was reconstituted with an expanded membership to help both the derivatives and cash markets prepare for, and successfully transition in the event of, a LIBOR phase out.
- What is the ARRC Business Loans Working Group?
  - 50 member firms and more than 100 individual members, representing sellside and buyside institutions, borrowers, trade associations and expert market participants
  - Co-chaired by the LSTA and ABA
  - Split into a number of sub-working groups, including syndicated loans, bilateral loans and operations
  - *First mandate*: Develop fallback language for syndicated loans that:
    - Is workable
    - Reduces systemic risk
    - Can be executed broadly if LIBOR is discontinued

ARRC Members	
AXA	JP Morgan Chase & Co.
Bank of America	LCH
BlackRock	MetLife
Citigroup	Morgan Stanley
CME Group	National Association of Corporate Treasurers
Deutsche Bank	PIMCO
Federal National Mortgage Association	TD Bank
Federal Home Loan Mortgage Corporation	The Federal Home Loan Bank of New York
GE Capital	The Independent Community Bankers of America
Goldman Sachs	The Loan Syndications and Trading Association
Government Finance Officers Association	SIFMA
HSBC	Wells Fargo
Intercontinental Exchange	World Bank Group
ISDA	
Ex Officio Members	
Board of Governors of the Federal Reserve	Federal Reserve Bank of New York
Bureau of Consumer Finance Protection	Office of Financial Research
Commodity Futures Trading Commission	Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation	Securities and Exchange Commission
Federal Housing Finance Agency	Treasury Department

The ARRC consultation for US$ syndicated loans

- What are the four components of LIBOR fallback language for syndicated loans?
  - **Trigger** – What event precipitates a transition from LIBOR to the new reference rate?
    - Mandatory Triggers
      - ISDA Triggers
      - Pre-cessation Triggers
    - Opt-in Triggers
      - Could reduce the inventory of loans that would have to be transitioned upon LIBOR cessation, thus reducing systemic risk
  - **Replacement Reference Rate** – What is the new reference rate for the loan?
  - **Spread Adjustment** – Because LIBOR and the replacement rate (likely SOFR) are different rates, there may need to be a spread adjustment to make them more comparable. What is the mechanism to determine that rate?
  - **Amendment Process** – Some variants of fallback language require amendments

- What are the ARRC's two proposals for syndicated loan fallbacks?
  - An "**Amendment**" approach that is similar to the fallback language that has been introduced in syndicated loan agreements over the past 12+ months.
  - A "**Hardwired**" approach that anticipates the transition from LIBOR and sets all the terms for that transition at the origination of the credit agreement (thus avoiding the need for an amendment in most cases). Closely aligned with the proposed fallback language for floating rate notes (and other cash products).

There are pros and cons to each approach

Amendment Approach	Hardwired Approach
Terms are not predetermined so may require many loans to be amended in short amount of time	Avoids amendments (in most cases)
Does not rely on terms that do not currently exist (Term SOFR, Compounded SOFR)	Predetermined terms means giving up flexibility
Opportunity for winners and losers	Less susceptible to gamesmanship
Similar to what the loan market has already developed / is familiar with	Inclusion will be a bigger change to current practice
Leverages loans' unique amendment flexibility	More closely aligned with other cash products

ARRC syndicated loan consultation – high level takeaways

- Preferred Approach
  - 46% Hardwired, 41% Amendment, 14% Both
  - Conclusion: Hardwired *ultimately* will be the right approach

- Triggers: Pre-cessation triggers are important; 73% also wanted an opt-in trigger

- Rate/Adjustment Preferences
  - 90% wanted forward looking term SOFR as first step in waterfall
  - 94% said compounded SOFR should be second step; “in arrears” favored
  - Overnight SOFR fixed for a period of time was not popular
  - 91% of respondents want the ARRC to publish a loan fallback spread adjustment – and 100% want it to be published on a screen

- Operational Challenges Flagged
  - Not knowing interest rate at the beginning of the period
  - Converting thousands of loans simultaneously
  - Other operational issues like multicurrency, different jurisdictions, alignment with derivatives, accounting & tax
  - ARRC operations sub-working group formed in 2019

The EMEA approach – Replacement of Screen Rate clause

- The LMA published a rider on 25 May 2018 with a revised version of the Replacement of Screen Rate clause (now publicly available on the Bank of England website, but applies across currencies)

- Facilitates further flexibility than the existing clause
  - permits amendments with a lower consent threshold than may otherwise be required in a wider range of circumstances

- Allows amendments to be made to facilitate inclusion of a replacement benchmark which:
  - is formally selected as a replacement for LIBOR by the LIBOR administrator or by an appropriate regulator; or
  - is otherwise accepted by the relevant markets; or
  - is deemed appropriate by the requisite majority of lenders and the obligors

- The clause can either apply at any time or upon a “Screen Rate Replacement Event”

- The clause was agreed with the ACT and borrower representatives

Euro RFR developments

– ESTER due to be published by October 2019 at the latest

– Request to European legislative authorities to extend BMR transitional period
  - political agreement reached on this

– Discussion paper on transition from EONIA to ESTER published in December 2018
  - feedback in favour of recalibrated EONIA published until end of 2021

– Consultation paper on determining an ESTER-based term structure methodology <u>as a fallback</u> in EURIBOR-linked contracts published in December 2018
  - feedback in favour of a forward-looking term rate based on tradable OIS quotes

– EURIBOR to be moved to hybrid methodology, for which BMR approval being sought

– Guiding principles on fallbacks for cash products published in January 2019

– LMA sits on Euro RFR WG and various sub-groups

Sterling RFR developments

- Working group conducted term rate consultation in 2018
  - found the development of a robust forward-looking term rate could help facilitate transition in certain segments of the cash market
  - use of OIS swap quotes, a blend of futures and OIS swaps data
  - interested benchmark administrators were required to respond by 15 February (NB: ICE Term RFR Portal)

- Sub-group on syndicated loans
  - chaired by the LMA
  - work has included: identifying transition issues, options for referencing SONIA, fallbacks to SONIA, how to transition legacy documents
  - Revised replacement of screen rate clause (May and October 2018)

- Paper on conventions for referencing SONIA in cash products

- Thinking on cash market adjustment spreads following ISDA consultation

- Infrastructure sub-group and forum looking at systems issues

Trade association cooperation

- Joint trade association monthly meetings
  - set up following the Andrew Bailey speech in July 2017
  - universally acknowledged that global coordination is essential to smooth transitions across the relevant jurisdictions
  - intended to establish regular communication, discuss key issues arising from transition and update each other on developments in relation to the transition
  - includes LMA, LSTA, APLMA, JSLA, ACT, ICMA, AFME, ISDA, SIFMA and others
  - minutes published on TA websites

- Fortnightly LIBOR calls between LMA and LSTA

Uptake of RFRs

– In the sterling market, approx. £17.5B of SONIA bond issuance; have been seen using a “lag” method

– In the USD market, nearly $50B of SOFR bond issuance; have been seen using a combination “lock-out” and “lookback” method

– To date, no syndicated loans have been transacted using the RFRs. A number of reasons why this is the case:

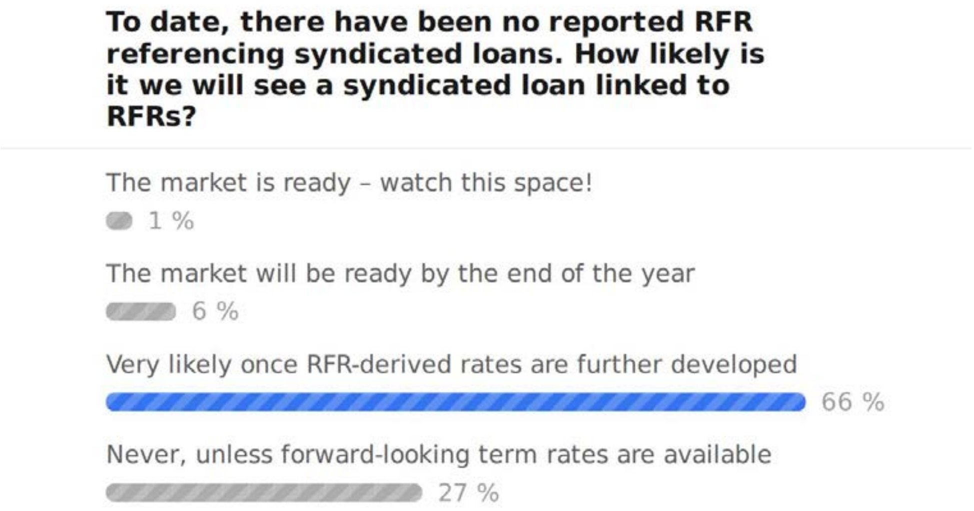
- no forward-looking term rates available yet
- the compounded methodologies are not (yet) operationally viable
- not all borrowers may be comfortable with the compounded methodologies

Audience poll

– To date, there have been no reported RFR referencing syndicated loans. How likely is it we will see a syndicated loan linked to RFRs?

- The market is ready – watch this space!
- The market will be ready by the end of the year
- Very likely once RFR-derived rates are further developed
- Never, unless forward-looking term rates are available

Audience poll – results



Questions?