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Newsletter IBOR Reform 01/2023

Compilation by the Helaba IBOR Task Force

Last Update 12 January 2023

Foreword by Helaba IBOR Task Force

Ladies and Gentlemen,

Welcome to our first IBOR Reform Newsletter in 2023. We hope you and your families had a wonderful festive season and have started the New Year well and healthy. On behalf of Helaba we would like to thank you very much for your cooperation last year with the transition to the new risk free benchmarks and wish you all the best for 2023!

The current geo-political environment, inflation, rising interests and energy costs are only some of the challenges that will keep us busy this year. And then there still is – yes, indeed – the IBOR reform. The main focus of IBOR reform in 2023 is on the transition of USD LIBOR legacy business. The milestone for this is 30 June 2023, at which time the remaining USD LIBOR rates will be discontinued. In view of the high market volumes to be transitioned consultations are ongoing regarding the publication of synthetic USD LIBOR rates that similar to synthetic GBP and JYP LIBOR rates would be available for a limited period of time to support the winding down of legacy business that cannot be transitioned in time until 30 June 2023. Synthetic rates cannot offer a permanent solution. We therefore kindly ask you to transition your USD LIBOR legacy business actively and in time with our support. Market conventions for a transition to SOFR Compounded or Term SOFR have been sufficiently established. For syndicated loans where we act as agent as well as for bilateral loans we will provide you with a transition proposal in the coming weeks.

Benchmark reform is also progressing in other currencies. In Poland, for example, the changeover of the WIBOR is taking concrete shape. In this issue of our newsletter, we are again focusing on those IBOR transition developments which we believe are important for our clients. Our compilations do not claim to be exhaustive.

As always, we are at your disposal for a personal exchange on the transition of USD LIBOR or other IBOR rates in existing contracts, for the structuring of new business with risk free rates as well as for exchanging on market observations.

In case of any questions please do not hesitate to contact either your relationship manager or send an e-mail to us at ibor-reform@helaba.com.

Highlights and Market Observations since 7 September 2022 (1/8)

- The transition of USD LIBOR legacy business will be intensively addressed in the coming months. Legacy contracts have to be amended until 30 June 2023, the cessation date of the remaining USD LIBOR rates. We are talking here about a significantly higher market volume to be transitioned than in the completed conversion of other LIBOR rates.
- We expect banks will increasingly contact their clients with transition proposals in the coming weeks.
- The USD LIBOR derivatives will transition to SOFR Compounded taking into account a spread adjustment fixed by ISDA and Bloomberg on 5 March 2021 for the economic compensation of using a new benchmark. For the USD LIBOR transition the following spread adjustments were set:

USD	Overnight	SUS00ON Index	0.00644
USD	1 Week	SUS0001W Index	0.03839
USD	1 Month	SUS0001M Index	0.11448
USD	2 Months	SUS0002M Index	0.18456
USD	3 Months	SUS0003M Index	0.26161
USD	6 Months	SUS0006M Index	0.42826
USD	12 Months	SUS0012M Index	0.71513

ISDA IBOR Fallbacks – Fixed Spread Adjustments dd. 5 March 2021

https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf
https://data.bloomberglp.com/professional/sites/10/IBOR-Fallback-Rate-Adjustments-Rule-Book.pdf

- USD LIBOR loans with a direct hedge have to be transitioned to SOFR Compounded analogue to the underlying derivative.
- It remains to be seen if the loan market will proceed with the transition of USD LIBOR legacy business without direct hedging according to the transition of previous LIBOR rates (Compounded Risk Free Rate + spread adjustment). For the loan market the forward-looking Term SOFR, which is already used for new business, is available as an alternative. Consequently, a uniform transition to SOFR Compounded or to Term SOFR is not expected. A trend has not yet emerged in the European loan market.

Highlights and Market Observations since 7 September 2022 (2/8)

- Although in July last year the ARRC (Alternative Reference Rates Committee) limited its recommendation for Term SOFR to the loan market, the required interbank derivatives market is slowly developing.
- After SOFR Compounded in arrears had been in strong demand and use in the European market as new reference rate for USD floating rate business, especially also for multicurrency credit facilities that use other backward-looking benchmarks like SONIA, SARON or TONA, an increasing demand from corporate entities for Term SOFR could be observed in recent weeks in the German market. Term SOFR is also the preferred rate for aircraft finance transactions.
- In the USA, market participants have been developing a preference for Term SOFR for some time now as its features as forward-looking benchmark trigger few changes from using USD LIBOR. Also, it is one of the SOFR rates supported by the ARRC as market-wide accepted, robust successor rate for the USD LIBOR.
- Due to uniform transition from LIBOR rates to backward-looking risk free rates, market participants in Europe early on had to adapt their processes, IT-systems, documentation and so on and are therefore usually in a position to process SOFR Compounded. Whereas, due to the later cessation date of most USD LIBOR rates for legacy business corporate entities in the US could longer await the developments for the formation of forward-looking successor benchmarks. Many corporates still would have to set up the relevant infrastructure for using backward-looking benchmarks and therefore clearly prefer a forward-looking benchmark that keeps adjustment requirements to a minimum.
- At the time of the first big IBOR transition wave there had been hardly any new business on the basis of Risk Free Rates (RFRs). With only few exceptions, the loan market transitioned – analogue to the derivatives market - GBP/CHF/JPY and first USD LIBOR legacy transactions incorporating the above mentioned spread adjustments.
- Meanwhile, RFRs have become firmly established in the market. Since the beginning of 2022 the successor rate SOFR in all its available types has to be used for new business.
- In Europe, Overnight SOFR, SOFR Compounded and Term SOFR are used exclusively.

Highlights and Market Observations since 7 September 2022 (3/8)

- For new business and in the case of refinancings a spread adjustment is normally no longer used, as the margin reflects the requirements of the contractual parties. At refinancings, the economic differences between the old and the new benchmark are directly priced into the margin.
- An exception are multicurrency credit facilities with a selection of interest periods where, for reasons of transparency, it is often easier for all contractual parties to continue using a spread adjustment or a so called Credit Adjustment Spread (CAS) together with a uniform margin grid across all currencies. With a separate CAS, the commitment fee which is being calculated as a percentage of the applicable margin, is not affected by the CAS and can be kept at a lower level. This is of interest especially in facilities with back-up character. In the case of USD drawings, the CAS is often combined with a previously separate USD premium.
- The experiences gained in connection with new business may influence the transition of USD LIBOR legacy loan business. The relevant contracting parties have to decide individually and based on the transaction type which successor rate shall be used for the transition of the underlying loan transaction. It is important that solutions are found for the transition of legacy business that meet the interest of all contractual parties. The result should not be a worse position compared to contracts not transitioned in time until 30 June 223 for which a synthetic USD LIBOR would apply which is expected to contain a CAS fixed on 5 March 2021.
- It can be observed that investors in the USA begin to reject proposals offered by borrowers for loan amendments that do not account for an economic adjustment when transferring to a new benchmark.

  https://www.bloomberg.com/professional/blog/debt-investors-losing-millions-on-libor-switch-start-to-fight-back/?tactic-page=640475
- Since LIBOR rates have tended to be higher than risk free rates due to a risk premium and to level out market distortions and volatilities, the standardised spread adjustments fixed on 5 March 2021 in connection with the underlying LIBOR cessation dates are based on 5-year historic median rates. These spreads are also recommended by the ARRC for the transition of USD LIBOR loans. For credit agreements that include the ARRC-hardwired fallback language, when a replacement occurs, generally USD LIBOR will be replaced with Term SOFR plus the ARRC recommended historically based spread adjustment.

Highlights and Market Observations since 7 September 2022 (4/8)

- The version of the Investment Grade Multicurrency Term and Revolving Facilities Exposure Drafts published by the LMA in 10/2022 replaced hand-knitted solutions and offers exemplary drafting for several situations. It has to be taken into account, that this still is an exposure draft and not yet an approved LMA standard.
- The Term SOFR was meanwhile also taken up into the documentation recommended by LSTA (Loan Syndications and Trading Association) for US-business.
- Due to the nature of the Term SOFR as a forward-looking benchmark for a period of 1/3/6 and 12 months we currently observe in the market, that break costs find unchanged application. This is different for SOFR Compounded. As this is an overnight rate, normally no break costs are charged. Usually, in return there is a limitation on the number of permitted voluntary prepayments.
- A zero floor is used for both Term SOFR as well as SOFR Compounded. If a CAS is agreed then the reference size should be reference rate + CAS in order to prevent a windfall profit for one party in the amount of the CAS.
- In our last newsletter we presented the CME Term SOFR as well as the ICE Term SOFR rates. The differences between both rates are marginal. As the ARRC declared itself in favour of the CME rates, banks prepared internally and externally and closed the relevant licence agreements for the procession of the CME Term SOFR rates. The use of ICE Term SOFR rates – also in hardwired fallback provisions – is currently viewed critically in some parts of the market.
- So far, no established practice can be observed for Term SOFR fallbacks. Usually, in the case of contractual transitions and refinancings fallbacks are based on the existing provisions:

    1. Interpolated Term SOFR; thereafter
    2. Historic Term SOFR; thereafter
    3. Interpolated Historic Term SOFR; thereafter
    4. Lenders’ costs of funds.

Highlights and Market Observations since 7 September 2022 (5/8)

- Other fallback provisions seen in the market also include a central bank rate in the fallback waterfall. In any case, reference bank provisions no longer apply for Term SOFR.
- As Term SOFR is quoted for 1/3/6 and 12 months interest periods shorter than one month automatically lead to a fallback situation. Therefore, interpolation between Term SOFR and SOFR Compounded is often agreed as fallback solution. Some market participants see distortions in this procedure. Practical experience still needs to be gathered and could shape further development of fallback agreements.
- SOFR Compounded could also be agreed upon as a fallback for Term SOFR. So far, this fallback has not yet established itself in the market. Especially for facility agreements that do not contain a compounded rate structure there exists a certain reluctance to add extensive wording covering the compounded topic just for a fallback situation.
- Respondents to the British Financial Conduct Authority's (FCA) June 2022 consultation highlighted a significant number of contracts in cash markets, in particular cash markets outside the United States, that would neither transition to alternative rates at the end of June 2023 nor be covered by legislative provisions and would therefore benefit from a period of publication of USD LIBOR on a synthetic basis.
- Consequently, the FCA proposed in a further consultation on 23 November 2022 to require LIBOR's administrator, IBA, to continue to publish the 1-/3- and 6-month USD LIBOR settings under an unrepresentative 'synthetic' methodology for a temporary period until end-September 2024. After this, publication would cease permanently.
- While the FCA considers synthetic LIBOR a fair and reasonable approximation of what LIBOR might have been, it will no longer be representative for the purposes of the Benchmark Regulation. Therefore, it is intended as a bridge to appropriate alternative risk-free rates for use in certain legacy contracts only, but not for use in new contracts. Market participants should continue to prioritise active transition and focus on converting their legacy contracts to risk-free rates as soon as possible.
- The consultation run until 6 January 2023. The FCA expects to announce its final decision in late Q1/early Q2 2023.
  https://www.fca.org.uk/news/news-stories/further-consultation-announcements-wind-down-libor

Highlights and Market Observations since 7 September 2022 (6/8)

- Provision of synthetic LIBOR settings:
  - **GBP LIBOR**
    - → The 1- and 6-month synthetic GBP LIBOR settings will cease at end-March 2023
    - → Publication of the 3-month synthetic GBP LIBOR setting to be extended until end-March 2024, when it will permanently cease
  - **JPY LIBOR**
    - → The 3 months synthetic JPY LIBOR settings were terminated at end-2022
  - **USD LIBOR**
    - → the overnight, 1-/3-/6- and 12-month USD LIBOR settings will cease at end-June 2023

    <u>under consultation</u>:
    - → Publication of 1-, 3- and 6-month synthetic USD LIBOR settings until end-September 2024
    - → Use CME Term SOFR plus the relevant ISDA fixed spread adjustment as the methodology for a synthetic USD LIBOR.
    - → Permit all legacy contracts other than cleared derivatives to use a synthetic USD LIBOR.

Highlights and Market Observations since 7 September 2022 (7/8)

- Following recommendations of the working group on euro risk-free rates to include a forward looking €STR term rate based fallback into the EURIBOR referencing products, the European Money Markets Institute (EMMI) announced on 14 November 2022 in its function as reference rate administrator of the EURIBOR the introduction of the Euro Forward-Looking Term Rate (EFTERM) as successor rate for the EURIBOR. As part of its obligations under the EU Benchmark Regulation, EMMI is thus providing an alternative benchmark to EURIBOR users in the event of a EURIBOR failure.
- The EFTERM, which has already been released since May 2022 as part of a test phase, is announced at 11:15 CET every TARGET2 day for five tenors: 1 week, 1/3/6 and 12 months. As forward-looking benchmark and to ensure robustness in the underlying interest, the benchmark determination methodology for the EFTERM follows a three-tier waterfall approach:
  - Level 1: Consists primarily of €STR-based Overnight Index Swap (OIS) tradeable bid and offer prices and volumes collected for the defined tenors on selected trading places on a daily basis.
  - Level 2: If the amount of data on level 1 is not sufficient, €STR referenced OIS-dealer-to-client-quotes for the defined tenors are included.
  - Level 3: If no sufficient amount of data is available for level 2, €STR based future prices (overnight rates) with a tenor of up to one year are used.

  https://www.emmi-benchmarks.eu/benchmarks/efterm/

  https://www.emmi-benchmarks.eu/globalassets/documents/pdf/efterm/d0397-2022---efterm-benchmark-statement.pdf

  https://www.emmi-benchmarks.eu/globalassets/documents/pdf/efterm/d0354a-2022-benchmark-determination-methodology-for-efterm.pdf

  https://www.emmi-benchmarks.eu/benchmarks/efterm/governance/

- With publication of EFTERM EMMI provided the opportunity to arrange a fallback for a potential EURIBOR failure. Further market developments and practical experiences remain to be seen. It is too early for an assessment of the EFTERM or the Term €STR rate published by Refinitiv as potential fallbacks.

Highlights and Market Observations since 7 September 2022 (8/8)

- On 26 October 2022 Refinitiv introduced a prototype forward-looking risk-free Term €STR rate to support market participants as they commence testing in preparation for the introduction of robust fallback language in EURIBOR contracts.
- Refinitiv Term €STR is available daily in 1 week, 1/3/6 and 12 months tenors. It adopts a waterfall methodology that uses dealer-to-client bids and offers quotes from Tradeweb's institutional trading platform as the primary source and an integrated fallback based upon compounded €STR as the secondary source. The Tradeweb data is collected over 09:00-16:00 CET on the day before publication to ensure sufficient quotes are available for a robust prototype.

  https://www.refinitiv.com/en/media-center/press-releases/2022/october/refinitiv-launches-prototype-forward-looking-estr-term-rate
  https://www.refinitiv.com/en/financial-data/financial-benchmarks/refinitiv-term-estr

- The practical application of EFTERM and Term €STR requires corresponding bank-internal authorisations and the conclusion of licence agreements.

Poland: Transition to WIRON (1/2)

- Replacement of WIBOR and WIBID benchmarks with WIRON (Warsaw Interest Rate Overnight) index – Schedule / Milestones:

2022 ▫ Preparatory Phase

→ Q3/2022: National Working Group (NGR) for benchmark reform selected WIRON as the recommended alternative to the WIBOR benchmark. The calculation methodology for WIRON is the same as for WIRD (Warsaw Deposit Market Index), an index developed and published by GPW Benchmark and remains unchanged. The change of the future's critical benchmark's name was carried out to better reflect its characteristics and its reliance on the data representing overnight transactions.

→ Q4/2022: GPW Benchmark closes the adjustment process, ensures the availability of the index and publishes the relevant documents. All formal requirements have been fulfilled to start using WIRON in financial contracts. Changes in ISDA Definitions are to be published to include WIRON and allow promotion in the international market. Publication of NGR's analytical documents and recommendations defining the standards for application of the WIRON index in loans, bonds and derivatives and the recommended interest rate conventions for WIRON-based instruments. WIRON is available for application in new financial instruments since 12/2022. https://gpwbenchmark.pl/index-data-and-statistics

2023 ▫ Implementation Phase

→ Main objective: WIRON is fully available and can be used in financial products and instruments by entities that declare their preparedness to apply it. Regulation of the Minister of Finance to define the adjustment spread and the date from which the replacement applies. Adjustment Spread similar to other IBOR transitions, i.e. five-year period of the historical differences between the current benchmark and the new benchmark.

→ Adjustments of IT systems, internal processes and contract forms; educational and awareness-raising campaign regarding the application of the new benchmark and gradual introduction of the newly selected benchmark into financial contracts and instruments; banks may offer WIRON-based loans in parallel with WIBOR-based loans.

→ The process of building liquidity in the overnight indexed swap (OIS) market is under way for derivatives for which WIRON is to be the interest rate benchmark. In the initial phase, swap transactions are bilateral, i.e. they will be settled between two parties to the contract. Gradual accumulation of liquidity in the derivatives market aims to create a term structure for WIRON, which is conducive to the development of the cash instruments market. Changes to ISDA Definitions and IBOR Fallbacks Protocol are published, covering the introduction of clauses pertaining to the replacement of WIBOR in the existing derivative instruments.

Poland: Transition to WIRON (2/2)

2024 □ Phase Out

- → The plan is to create a space for phasing out WIBOR-based products and instruments and promote WIRON-based products and instruments, until the former ones are completely phased out.
- → Banks and other entities offer new WIRON-based products, mainly to consumers, sole traders, and companies. In particular, banks are offering housing loans at an interest rate based on the WIRON, with parallel development of the housing loan market based on a fixed/temporarily fixed interest rate. New bonds linked to WIRON or new fixed interest rates bonds are issued, including bank bonds, corporate bonds, and municipal bonds. National and international clearing houses (KDPW_CCP, LCH, etc.) achieve regulatory and operational preparedness and start to centrally clear OIS derivative transactions for which WIRON is to be the interest rate benchmark.
- → In consequence, the derivatives market shifts from the phase of bilateral transactions to the phase of centrally cleared transactions. The main component of market infrastructure, i.e. the service of clearing swaps based on the new benchmark, is provided. The OIS market achieves the required liquidity, necessary to build the term structure for WIRON.
- → The adjustment of market participants' IT systems, internal processes and contract forms is completed for all types of products and other elements that require effective implementation of the index in financial contracts and products. By the end of the year, clearing houses ensure the conversion of the existing WIBOR-based derivative contracts into WIRON-based instruments, pursuant to the ISDA IBOR Fallbacks Protocol.

2025 □ Finalisation Phase

- → Ensure widespread use of the RFR and provide for the preparedness to cease WIBID and WIBOR Reference Rates calculation and publication.
- → Following the entry into force of the Regulation of the Minister of Finance, financial institutions carry out the conversion of the existing WIBOR-based contracts and instruments, in accordance with the rules laid down in the Regulation. The replacement and the adjustment spread specified in the Regulation of the Minister of Finance are applied in contractual clauses on interest rates.

https://intranet.knf.gov.pl/knf/en/komponenty/img/mapa_drogowa_ang.pdf

Selected further Reference Rates – Update (1/2)

- Our newsletters focus primarily on the main benchmarks requested by our clients. Nevertheless, the implementation of the benchmark reform also affects other IBORs. Against this background we reported in our newsletter 08/2021 on selected reference rates beside USD/GBP/EUR/JPY/CHF LIBOR and potential replacement rates in further jurisdictions. In the following overview, we have compiled for you the most important current reference rates for these jurisdictions without any obligation. Further information on these benchmarks can be found at the relevant nationals banks and working groups.

Jurisdiction	Currency	Reference Rates	Administrator	Comments
	DKK	CIBOR	Denmarks Nationalbank	CIBOR is not regarded as critical benchmark. Re-determination took place in 03/2022. DESTR, introduced in 04/2022, will replace the Tom/Next rate from 2026. Until then a changed methodology applies: Tom/Next + 19bp = DESTR https://www.nationalbanken.dk/en/marketinfo/DESTR/Pages/default.aspx / https://dfbf.dk/dfbf-provides-a-one-off-spread-between-destr-and-tom-next/
		Tom/Next (Cessation 1 January 2026)		
		DESTR (Denmark Short-Term Rate)		
	SEK	STIBOR	Swedish Financial Benchmark Facility	Riksbank recommends to market participants to use SWESTR instead of STIBOR for the shortest interest period and to transition to transaction-based SWESTR in the near future. https://www.riksbank.se/en-gb/statistics/swestr/
		SWESTR (Swedish Krona Short Term Rate)	Riksbank	
	NOK	NIBOR	Norske Finansielle Referenser AS (NoRe)	No indication that NIBOR is to be replaced, NOWA and NIBOR probably to be used as parallel reference rates https://www.norges-bank.no/en/topics/liquidity-and-markets/nowa/
		NOWA (Norwegian O/N Weighted Average)	Norges Bank	
	CZK	PRIBOR	Czech Financial Benchmark Facility	Revised calculation methodology, no cessation planned

Sources: Central banks, benchmark regulators, financial markets

Selected further Reference Rates – Update (2/2)

Jurisdiction	Currency	Reference Rates	Administrator	Comments
	HUF	BUBOR	Central Bank of Hungary	BUBOR was reformed, no cessation planned
	PLN	WIBOR	GPW Benchmark	Replacement of WIBOR and WIBID benchmarks with WIRON in several phases until 2025 See previous pages of this newsletter for more details
		WIBID		
		WIRON (Warsaw Interest Rate Overnight)		
	CAD	CDOR	Refinitiv Benchmark Services (UK) Limited	Transition to CORRA in 2 phases until end of June 2024 (see also Helaba Newsletter 09/2022 https://www.helaba.com/de/ueber-uns/rechtliche-hinweise/ibor.php) No publication of 6- and 12-month-CDOR rates since 17 May 2021, remaining 1/3/6-month CDOR rates to be permanently terminated after 28 June 2024.
		CORRA	Bank of Canada	
	HKD	HIBOR	Treasury Markets Association	HIBOR has undergone a series of reforms. Multiple rate approach: HIBOR to be continued next to HONIA.
		HONIA (Hong Kong Overnight Index Average)		
	SDG	SIBOR (Cessation on 31 December 2024)	ABS Benchmarks Administration	Transition of SIBOR (Singapore Interbank Offered Rate) and SOR (Swap Offer Rate) to SORA Publication of 6- and 12-month SIDOR rates has been terminated. Cessation of 1- and 3-month SIBOR rates planned for 31 December 2024. https://abs.org.sg/benchmark-rates/transition-roadmap
		SOR (Cessation of 30 June 2023)		
		SORA (Singapore Overnight Rate Average)	Monetary Authority of Singapore	

Sources: Central banks, benchmark regulators, financial markets

Useful sources of information for current developments

For latest information as well as general details on the transition from IBORs, please also refer to information published by supervisory authorities, working groups and other industry organisations. A selection of the most important websites can be found here:

	€STR: European Central Bank EURIBOR: Emmi Working Group on Euro Risk-Free Rates
	Bank of England Financial Conduct Authority
	Federal Reserve Bank of New York The Alternative Reference Rates Committee (ARRC)
	SIX Swiss Exchange National Working Group on Swiss Franc Reference Rates (SNB)
	Bank of Japan Cross-Industry Committee on Japanese Yen Interest Rates Benchmarks
	ISDA Loan Market Association (LMA) LSTA

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