Values with impact. Helaba

Newsletter IBOR Reform 04/2023

Compilation by the Helaba IBOR Task Force

Last Update 28 April 2023

Foreword by Helaba IBOR Task Force

Ladies and Gentlemen,

Welcome to our follow-up IBOR Reform Newsletter on the current market developments especially in the USD LIBOR transition. With the cessation date for the remaining USD LIBOR rates coming up fast, the USD LIBOR transition is taking up speed. Despite the relentless effort of market participants to comply with an active and timely transition until 30 June 2023, the massive USD LIBOR market volume might make it difficult to wind down or transition all legacy transactions until then. In this light, the FCA's announcement of the publication of synthetic USD LIBOR rates provides a welcoming fallback solution for cases where a timely winding down is not possible or to help along transactions that have only one or two interest periods left before maturity.

If you still have contracts on USD LIBOR basis we kindly encourage you to actively transition these transactions before 30 June 2023. Please let us know if we can be of assistance. For syndicated loans where we act as agent as well as for bilateral loans we have provided our clients with transition proposals. Our Newsletter compilations do not claim to be exhaustive, but 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.

We would like to highlight our workshops ***"SOFR isn't just SOFR – The new USD reference rates in corporate financing"*** *at the 34th Finance Symposium in Mannheim on 11 May 2023. Following IBOR transition USD are experiencing a renaissance in the promissory note market. After the market came to a standstill in 2020, a volume of almost USD 1bn was issued again in 2022. Using the example of the USD Schuldschein of Brenntag SE, we discuss the choice of suitable reference rates, venture a look at the future developments of the market and thus provide an indication of how companies can position themselves. You are very welcome to join our panel discussion on current market observations in the loan and derivatives markets.*

https://finanzsymposium.com/en/blog/event/donnerstag-slot-1-workshop-10/ *https://finanzsymposium.com/en/blog/event/donnerstag-slot-2-workshop-8/*

As always, 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 12 January 2023 (1/9)

- On 15 March 2023, the US Alternative Reference Rates Committee (ARRC) released a paper formally stating its selections and recommendations as the 'Relevant Governmental Body' under its recommended hardwired fallback with respect to overnight, 1-/3-/6-/12-month USD LIBOR tenors. Implementation of the hardwired language requires verification of certain recommendations made by the ARRC, including: (i) whether the ARRC has selected or recommended a forward-looking term rate based on SOFR as LIBOR replacement for a given cash product; (ii) the ARRC's recommendations of spread adjustments; and (iii) the ARRC's recommendations of replacement indexes for use in consumer LIBOR products.

LIBOR Rate	ARRC-Recommended Replacement Rate	ARRC-Recommended Spread Adjustment
Overnight LIBOR	SOFR	0.00644 %
One-month LIBOR	One-month CME Term SOFR	0.11448 %
Three-month LIBOR	Three-month CME Term SOFR	0.26161%
Six-month LIBOR	Six-month CME Term SOFR	0.42826 %
Twelve-month LIBOR	Twelve-month CME Term SOFR	0.71513 %

The ARRC notes that the selections and recommendations set out in the paper are intended only for use in those legacy LIBOR contracts that fall back to SOFR, and are not to be used in new contracts.

https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-Press-Release-Summary-of-ARRC-Recommended-Fallbacks.pdf

https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-statement-on-1-3-6-12-month-USD-LIBOR.pdf

- Following its consultation in November 2022 on the requirements of a continued publication of 1-, 3- and 6-month synthetic USD LIBOR after 30 June 2023 the Financial Conduct Authority (FCA) announced on 3 April 2023 its decision to require LIBOR’s administrator, ICE Benchmark Administration Limited (IBA), to calculate synthetic USD LIBOR rates.

https://www.fca.org.uk/news/news-stories/fca-announces-decision-synthetic-us-dollar-libor

Highlights and Market Observations since 12 January 2023 (2/9)

- The 1-, 3- and 6-month synthetic USD LIBOR settings will use the relevant CME Term SOFR Reference Rate plus the respective ISDA fixed spread adjustments that are also used for the transition of all USD LIBOR derivatives.

USD	Overnight	SUS0OON 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

- Use of synthetic USD LIBOR rates is permitted in all legacy contracts other than cleared derivatives to help ensure an orderly wind-down of LIBOR. From 1 July 2023, all exemptions of new use of USD LIBOR and its synthetic successor rate will be prohibited under the Benchmark Regulation.
- Unless unforeseen and material events were to happen, the publication of the synthetic USD LIBOR settings are supposed to cease on 30 September 2024. The FCA will review its decision in line with the requirements of the Benchmarks Regulation.
- The overnight and 12-month USD LIBOR settings will cease permanently at end-June 2023.
- With synthetic LIBOR only being a temporary bridge and not a permanent solution, the FCA encourages companies to continue to actively transition contracts that reference USD LIBOR. This is in line with recommendations from US authorities and the ARRC who have also highlighted the importance of acting now to remediate contracts to avoid a pile-up ahead of key dates.

Highlights and Market Observations since 12 January 2023 (3/9)

- In a statement published on 12 April 2023 **the Bank of England, FCA and Working Groups** encourage market participants to:
  - Actively transition USD LIBOR contracts ahead of the cessation of the USD LIBOR panel at end-June 2023;
  - Ensure readiness for implementation of USD LIBOR fallbacks, including planned central counterparty (CCP) conversion events and operationalisation of the ISDA 2020 IBOR Fallbacks Protocol;

Planned CCP conversion processes of outstanding LIBOR USD contracts to RFRs

CCP	Product	Timing of planned conversion
LCH	Swaps	22 – 23 April 2023 (Swaps tranche 1) 20 – 21 May 2023 (Swaps tranche 2)
CME	Swaps, futures and options	Weekend beginning 24 March 2023 (Swaps pre-conversion splitting) Weekend beginning 14 April 2023 (Futures and options) Weekend beginning 21 April 2023 (Swaps tranche 1) Weekend beginning 3 July 2023 (Swaps tranche 2)
Eurex	Swaps	Weekend beginning 21 April 2023

  - Ensure they transition to the most robust Risk Free Rates; and,
  - Continue to actively transition any remaining legacy contracts from synthetic GBP LIBOR to SONIA.

  https://www.bankofengland.co.uk/news/2023/april/usd-libor-panel-ceases-end-june-2023-are-you-ready

- The 1- and 6-month synthetic GBP LIBOR settings were ceased permanently on 31 March 2023. The 3-month synthetic GBP LIBOR will cease on 28 March 2024.

Highlights and Market Observations since 12 January 2023 (4/9)

- On 21 April 2023, the ARRC provided an extensive update to its **Term SOFR Scope of Use Best Practice Recommendations**, which is worth reading in detail as it is clarifying the ARRC's standing recommendations for all market participants. While the ARRC has recognised the use of Term SOFR in specific cases outlined in its summary to provide the markets with a useful tool to transition away from USD LIBOR, it continues to recommend use of Overnight SOFR and SOFR average rates for all products due to the robustness of these reference rates. Term SOFR rates are based on derivatives products, primarily SOFR futures markets, and not directly on the overnight Treasury repo market that underpins SOFR. According to the ARRC, the robustness of the Term SOFR rates thus relies on the continued existence of a deep and liquid SOFR derivatives market based on Overnight SOFR. Consequently, the ARRC is of the opinion that the use of the Term SOFR rates needs to remain limited, particularly in the derivatives markets, in order to remain consistent with financial stability and a sustainable system. Therefore, the ARRC Best Practice Recommendations do not support interdealer trading of Term SOFR. In its summary the ARRC observed that hedging with Term SOFR has generally been more expensive than hedging with overnight SOFR or SOFR averages.

  As the past year of experience has raised concerns that dealers may eventually build up positions that are so large as to render them unable to warehouse further additional Term SOFR exposures, the ARRC is now making a limited refinement to its recommended scope of use of Term SOFR.

  The Financial Stability Board has likewise noted that use of rates like Term SOFR should remain limited in order for their use to be consistent with financial stability.

  For a quick overview, we have compiled the scenarios the ARRC describes in its Best Practice Recommendations. In its summary, the ARRC provides a lot of additional information on the individual scenarios and the reasoning behind its recommendations.

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-Press-Release-Best-Practice-Recommendations.pdf

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-Term-SOFR-Scope-of-Use-Best-Practice-Recommendations.pdf

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-Readout-April-2023-Meeting.pdf

Source: ARRC

Highlights and Market Observations since 12 January 2023 (5/9)

- ARRC recommendation for use of Term SOFR in cash products and scenarios on use of Term SOFR in derivative transactions:

Source: ARRC

Highlights and Market Observations since 12 January 2023 (6/9)

Scenario 4: Investor Holding Term SOFR Assets Hedging of Term SOFR Risk

Scenario 5: Non-Market Making Bank Dealer Matches a Term SOFR Swap Issued to a Borrower with an Offsetting Swap from a Market Making Dealer

Scenario 6: Interdealer Trading of Term SOFR

Scenario 7: Fixed Rate Borrower with No Term SOFR Exposure Seeks to Swap to Term SOFR

Scenario 8: Trading of Term SOFR-SOFR Basis Swaps with a Non-Dealer

Scenario 9: Interdealer Trading of Term SOFR-SOFR Basis Swaps

Source: ARRC

Helaba

Highlights and Market Observations since 12 January 2023 (7/9)

- In recent months we have observed in the loan market, that **USD LIBOR** legacy transactions with a direct hedge are transitioned to SOFR Compounded analogue to the underlying derivative. USD LIBOR loans without direct hedging are either transitioned to SOFR Compounded or Term SOFR, depending on clients' preferences, their hedging strategies and technical equipment and readiness for using the new risk free rates. Consequently, a uniform transition to either SOFR Compounded or to Term SOFR cannot be observed in the European market. In the US there is a strong trend for using Term SOFR. While the derivatives market transitions business using the uniformly fixed ISDA spread adjustments, we observe in the loan market that different from the first transition wave to risk free rates, the Credit Adjustment Spreads (CAS) recommended by central banks, regulatory authorities and working groups are often not applied as recommended. This is especially true in US business, where we observe a trend towards a low flat rate CAS covering all interest periods, which not fully addresses the economic difference between the old and new reference rates.

- As **CDOR** will cease on 28 June 2024, the Canadian Alternative Reference Rate working group (CARR) published an impact assessment checklist to help market participants assess and mitigate their exposures to CDOR. Given how deeply embedded CDOR is in the financial ecosystem, it is important that market participants with exposures to CDOR act quickly to prepare for the discontinuance of CDOR. As part of a two-stage plan, initially no new CDOR derivative transactions (with limited exceptions) or new CDOR based cash securities are to be contracted starting July this year. In a second stage loans are to be transitioned from CDOR until 28 June 2024. Since the beginning of this year new loans can be based on the new risk free rate CORRA. Starting in Q4 2023, the loan market should also be able to use a 1- and 3-month Term CORRA.

  https://www.bankofcanada.ca/2023/03/carr-publishes-impact-assessment-checklist-market-participants-cdor-exposure/

  https://www.bankofcanada.ca/wp-content/uploads/2023/03/impact-assessment-checklist.pdf

  https://www.bankofcanada.ca/wp-content/uploads/2023/02/CARR-milestones.pdf

Highlights and Market Observations since 12 January 2023 (8/9)

- On 15 February 2023, Sweden's central bank, Sveriges Riksbank (the Riksbank), published a consultation seeking views on its proposals to bring forward publication of the risk free rate **SWESTR** (Swedish Krona Short Term Rate) from 11:00 CET to 9:00 CET starting 2 May 2023 and to increase the transparency of the transaction dataset for SWESTR by 1 June 2023. On 31 March 2023, the decisions to implement these proposals were confirmed.

  https://www.riksbank.se/en-gb/press-and-published/notices-and-press-releases/notices/2023/consultation-on-swestr/

  https://www.riksbank.se/en-gb/press-and-published/notices-and-press-releases/notices/2023/consultation-on-swestr/

- The European Parliament and Council of the EU tasked the EU Commission with a full review of the rules for **non-EU benchmarks** by mid-2023. Under the Benchmark Regulation (BMR) non-EU (third country) benchmarks can only be applied from 1 January 2024, if they comply with rules that are comparable to the BMR. As very few jurisdictions have as extensively regulated benchmarks as the EU, so far very few non-EU administrators have taken the effort to obtain access to the EU market through recognition or endorsement. Once the new rules on the use of non-EU benchmarks are in force, market participants in the EU would be deprived of access to the majority of the world's benchmarks that are used within the EU to hedge risks, measure markets and gain investment exposure. Several banks, organisations and national banks have already provided their assessments and recommendations.

  https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13762-Benchmarks-Regulation-review-of-the-scope-and-regime-for-non-EU-benchmarks_en

  According to information from the EU Commission it is working on a legislative proposal to extend the exemption rule for non-EU benchmarks until the end of 2025.

Highlights and Market Observations since 12 January 2023 (9/9)

- On 3 February 2023, the Working Group on Euro Risk-Free Rates (the EURO RFR WG) provided an update in relation to the adoption of **EURIBOR fallbacks**. It was highlighted that while derivative and bond market standards for €STR based EURIBOR fallbacks are established, market practice for this is not yet developed in the loan market. In the loan market, traditional fallbacks (such as cost of funds and replacement of screen rate language) are still predominantly in use, with the EURO RFR WG's EURIBOR fallback recommendations not generally adopted. Further, the €STR Task Force noted that it was too early to consider recommending or endorsing a **specific Term €STR** as a fallback to EURIBOR, or for the market to establish a preferred term rate. The use of €STR in new business origination across bond and loan markets remains limited.

  In light of the above, it was proposed that in Q1/2023 the €STR Task Force would work on complementing the May 2021 EURIBOR Fallback Recommendations, focusing on areas such as the loan market where EURIBOR fallback adoption appears more challenging. Particularly, now that Term €STR is available as a fallback rate, the €STR Task Force can prepare a more granular recommendation for this specific market segment. The EURO RFR WG expects to provide further clarity and guidance to facilitate the practical implementation of the recommendations and promote standardised market practice.

  In Q2 and Q3 of this year, the €STR Task Force will assess whether there are any barriers for the adoption of Term €STR rates as EURIBOR fallbacks and consider possible remedial action.

  https://www.esma.europa.eu/sites/default/files/library/EUR_RFR_WG_-_13_December_2022_Meeting_minutes.pdf

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

Disclaimer

- The information contained in this document does not constitute an offer, a recommendation or advice, but is provided for the purpose of product description only. Information provided is based upon sources which are considered reliable, but no warranty can be assumed for the accuracy, completeness or adequacy.
- Helaba does not provide any tax, accounting and/or legal advice; such matters depend on the individual circumstances of each customer and should be discussed with independent advisors and counsel before entering into any transaction. Fiscal, accounting and/or legal treatment may be subject to changes in the future.
- Any third party use of this publication without our prior written authorization is prohibited.