LIBOR Transition

Communication Strategy

Frequently Asked Questions (FAQs)

1st October 2021

Purpose of FAQ

This list of Frequently Asked Questions ("FAQ") is provided to inform our customers and counter-parties of the circumstances regarding the cessation of LIBOR and is indicatively for information purposes only and may not represent the views of FCMB, its employees or officers.

The information presented does not constitute legal, tax, financial or accounting advice and FCMB does not guarantee accuracy, completeness, or timeliness of provided information, particularly as aspects of the reform are still evolving.

Clients should consider appropriateness of contractual fallbacks and potential loan amendments together with their legal, tax, financial and accounting advisers, considering their circumstances.

1 - What are LIBOR and IBOR rates?
IBOR stands for "Interbank Offered Rate" and refers to benchmarks indicative of interest rates at which banks lend to and borrow from each another in the interbank market.

LIBOR, the London Interbank Offered Rate, has been most established and is currently published in 5 currencies for 7 tenors, with interest rates determined from submissions by a panel of contributing banks.

The benchmark rates have been used for decades as underlying in numerous financial products, as well as for discounting and valuation purposes. EURIBOR (the Euro interbank offered rate) is another widely used IBOR use for the EUR currency.

2 - Why are they being replaced or reformed?
The methodology used to determine IBOR rates has historically been based on quotes submitted by the panel banks to the relevant benchmark administrator, such as ICE Benchmark Administration (IBA), who publishes LIBOR.

Following the global financial crisis, these submissions have become less and less rooted in actual underlying transactions, and have instead been increasingly reliant on expert judgement, because alternative funding sources have increasingly replaced banks' unsecured interbank lending.

This led the Financial Stability Board (FSB) to mandate change in 2014. Benchmark Regulation was also introduced, to ensure robust benchmark methodologies existed which reflected underlying economic positions.

The UK Financial Conduct Authority ("FCA"), which authorizes and regulates ICE Benchmark Administration (IBA), announced in 2017 the discontinuation of LIBOR submissions by the end of 2021.

In the case of EURIBOR, while it is also an IBOR benchmark, the relevant competent authority has opted to reform to make it compliant with Benchmark Regulation rather than discontinuing the publication for the time being.

3 - When will the transition happen?
On 5 March 2021, the FCA formally announced the future cessation or loss of representativeness of all 35 LIBOR benchmark settings currently published by ICE Benchmark Administration (IBA), under supervision by the FCA.

All GBP, EUR, CHF, and JPY LIBOR settings, as well as one week and two months USD LIBOR will cease following publication on December 31, 2021. Given oversight in the US, it has been decided that overnight, one, three, six and 12-months USD LIBOR settings will cease to exist after publication on June 30, 2023.

Under new powers granted to UK regulators by the Financial Service Act 2021, the FCA is currently in consultation on requiring the IBA to continue publishing the 1-month, 3-month and 6-month GBP and JPY LIBOR settings for a period after end-2021 on a changed methodology. Published rates, also referred to as synthetic LIBOR, are proposed to be based on available term rates associate with official alternative reference rates, and are intended for limited use with tough legacy contracts, (i.e., contracts negotiated prior to end of June 2021 with no or inappropriate fall-back rate alternatives and have realistic ability to be renegotiated or amended).

Continued publication on a synthetic basis and for limited use is also being considered by the regulators for the 1-month, 3-month and 6-month USD LIBOR settings for a period after the end-June 2023 cessation.

4 - What are the alternative reference rates?
Early in the LIBOR Transition process, the official sector and convened National Working Groups in the relevant jurisdictions have identified near "risk-free rates" (RFRs) as potential "alternative reference rates" (ARRs) to replace IBORs and be used in fallback provisions of IBOR contracts.

The official replacement benchmarks for each of the LIBOR currencies are overnight rates, including SONIA (GBP), SOFR (USD), SARON (CHF), TONAR (JPY) and €STR (EUR).

Some have already been well established in the Overnight Interest Rate Swap derivative markets, or were associated with predecessor rates, whilst the New York Federal Reserve began publication of SOFR only in April 2018. Liquidity and adoption therefore differ across the alternative reference rates in each LIBOR currency and markets continue to evolve.

In the US market, a selection of proprietary credit-sensitive benchmark rates has also become available, although National Working Groups have not endorsed any benchmark alternatives to LIBOR other than the official alternative reference rates and respective term rates, where they exist. No new LIBOR based contracts may be issued after the end of 2021 although legacy contracts may continue to use LIBOR where no alternative has been agreed.

5 - How will the alternative reference rates work?
The alternative reference rates in each of the relevant currencies are overnight rates, observed daily over an interest period, and the daily rates may be compounded in-arrears at the end of that interest period, only a few days prior to the interest payment date. As a result, expected cash flows will be known at a later time (after the interest charging period), compared to a forward-looking rate like LIBOR. The Bank is looking at forward-looking alternative reference rates for specific facilities where possible.

However, the daily overnight rates are representative, as derived from a much larger number of actual underlying transactions, and the rates have proven robust during times of market stress, as seen in the pandemic spring of 2020. Most of the rates are unsecured, but USD and CHF rates are secured.

As daily overnight rates the alternative reference rates are neither credit-sensitive, as they don't include the panel banks credit risk premium, nor do they reflect a liquidity premium based on the length of the interest period. Therefore, it is likely an adjustment spread to reflect the tenor and credit will be added.

6 - Will there be forward-looking rates?
For selected products and transition use cases, the need for forward-looking term rates has been acknowledged by various National Working Groups. Development of term rates has been progressing, and these rates also have a key role in solutions proposed by the UK regulator to support transition of tough legacy contracts.

In the UK, ICE Benchmark Administration (IBA) and Refinitiv Benchmark Services (UK) Limited have been publishing forward looking Term SONIA rates since January 2021.The term rates are based on OIS derivatives transactions and available for one, three, six, and 12-months tenors. Whilst some term rate use cases have been acknowledged, regulators prefer wide adoption of SONIA compounded in arrears.

In US markets, there have been forward-looking proprietary term rates, in addition to the officially selected SOFR overnight alternative reference rate. The US official sector have seen the need for a complementary term SOFR rate.

CME was officially appointed by the New York Federal Reserve's Alternative Reference Rates Committee (ARRC) and began publication of forward-looking Term SOFR rates for 1-month, 3- month, and 6-month tenors in April 2021. These term rates, based on SOFR Futures have been officially endorsed on 28 July 2021.

AMERIBOR is a benchmark rate that reflects borrowing costs of small, medium, and regional banks across the US and more recently BSBY was introduced, to name a couple. Both are forward-looking term rates, and have a credit-sensitive component, but don't have regulatory approval for use in the UK.

Complementing TONAR overnight rates in Japan, Quick Corp (QBS) publishes the Tokyo Term Risk Free Rate (TORF), which is based on uncollateralized overnight call rate which calculates the interest rate from derivative transaction data for a period of one or three months.

The Working Group on Euro Risk Free Rates (EUR) intends to develop a term rate for €STR, whilst the National Working Group on Swiss Franc Reference Rates (CHF) has indicated that a term rate cannot be produced for SARON.

7 - What will happen with EURIBOR?
EURIBOR is an IBOR that will not be discontinued as it is BMR-compliant and can continue to be used in existing or new contracts.

EMMI, the European Money Markets Institute, as administrator of EURIBOR completed in-depth reforms over the last few years to meet the EU Benchmarks Regulation requirements. By strengthening its governance framework and developing a hybrid methodology for the benchmark, it is now considered a sufficiently transparent, robust, and representative index, where risks of market manipulation are also minimised.

On 2nd July 2019, EMMI was granted authorisation by its regulator, the Belgian Financial Services and Markets Authority (FSMA) under Article 34 of the EU Benchmarks Regulation for the administration of EURIBOR.

The reform of the EURIBOR methodology necessitates a corresponding change in fallback language to ensure any cessation or non-representative events can be accommodated.

8 - What is meant by 'fallback language' and 'trigger events?
Fallback language refers to legal provisions in financial contracts, including credit facility agreements, that apply if the underlying reference rate in a financial product is unavailable. Historically, permanent discontinuation has not been considered in these clauses, so fallback language was adapted to suitable accommodate the permanent cessation of an index.

New best practices for fallback language have been established. As part of this development, trigger events were defined, which include cessation announcements as well as pre-cessation announcement, when a rate is or will be at a specified future date no longer be considered representative or available in the market.

Therefore, fallback consists of two components. The trigger event determines what triggers the need to use a fallback rate. The fallback rate itself specifies the benchmark rate which will replace the IBOR rate when a trigger event occurs. To offset differences between the rate types and minimise value transfer, an applicable spread adjustment is added, as established for example under the ISDA Protocol or industry guidance, developed by the Alternative Reference Rate Committee (ARRC).

9 - What is the credit spread adjustment (CAS) and why is it needed?
Calculation of LIBOR and alternative reference rates are based on different methodologies, and the daily overnight rates lack the credit risk and liquidity term premiums included in LIBOR rates. To make them more comparable and overcome value transfer as part of the LIBOR transition, a market standard Credit Adjustment Spread (CAS) was established for derivatives through industry consultation.

The resulting ISDA IBOR Fallbacks Supplement and Protocol is based on the historical 5-year median spread between LIBOR and the alternative reference rates. It has found applications in cash markets, too following the index cessation event on 5th March 2021 the CAS have now been fixed/agreed/published for all LIBOR settings.

However, the Bank is monitoring market developments and will agree replacement spread adjustment figures at a later date.

10 - What does this mean for me?

You can expect your financial services providers to reach out to you regarding financial contracts impacted by LIBOR Transition given this change is actually happening and has Regulatory Oversight. If you will be impacted by the cessation of LIBOR the Bank will be contacting you to ensure you are aware of the changes and agree replacement rates. Accordingly, FCMB UK will communicate with you directly as a part of the LIBOR Transition planning process.

You may still want to review your business comprehensively and identify financial or commercial contracts referencing any benchmarks that are due to be discontinued, to assess whether suitable fallbacks are in place, or whether transition away from LIBOR needs to be addressed.

You may also want to consider seeking independent professional legal, financial, tax, accounting or other advice on impacts across your business.

11 - What are our plans for the transition?

We have a LIBOR Transition governance and implementation programme, delivering the product and operational capabilities required to continue offering our clients the current product offering in the post-LIBOR era.

We have completed a review and identified impacted client contracts, including contracts extending beyond the respective LIBOR cessation dates, as well as contracts likely due for refinancing during the LIBOR transition period.

We are developing our range of official alternative reference rate products, in addition to existing rate products suitable to replace LIBOR-linked business going forward.

We are in the process of reaching out to our clients, to communicate changes, our future product offering and to discuss legacy contract amendment or refinancing needs. Our team is ready to respond to your queries and as a start point, please discuss any issues or concerns with your FCMB UK Relationship Manager.

12 - How will the transition affect my loans?

Your loans will only be impacted if they are LIBOR-linked and have rate reset dates beyond the index cessation dates.

In that case they will require suitable fallback provisions for permanent index cessation, or active transition in line with the regulatory target dates prior to the benchmark cessation date. The Bank will be contacting impacted customers in due course and will be working with them to agree replacement reference rates as necessary and carry out amendments to existing contracts to ensure the requirements are met.

Loans due for refinancing prior to the end of this year will need new loan agreements with alternative rates.

The Bank will contacting impacted customers directly to agree appropriate replacement rates.

In the case of USD, loans may still be issued referencing LIBOR until the end of the year but will require robust fallback language or pre-arranged transition provisions, if they mature after June 2023, when all USD LIBOR tenors are due to end.

13 - How will it impact Trade Finance transactions?

Trade Finance products have been amongst the use cases for term rates acknowledged by the official sector and national working groups. The applicable interest rate needs to be known at the outset of the transaction, especially where financing is offered at a discount.

USD LIBOR is the most widely used benchmark across the trade finance industry globally. Hence, development and official endorsement of Term SOFR on 28 July have been crucial milestones.

Trade market associations, including BAFT and ITFA will still have to finalise conventions and provide updated standard documents, such as the MPA and the MTLA are expected The Bank will closely monitor developments in the Trade Finance sector and implement new documentation after consultation with impacted customers.

14 - Will my mortgage be impacted?
We have not issued LIBOR-linked Buy-To-Let mortgage products, so none of our mortgages will be impacted by LIBOR Transition.

15 - What does it mean for loan contracts beyond this year?
LIBOR-linked loan products in currencies other than USD with rate reset dates beyond the end of this year are in scope for LIBOR transition by the end of Q3/2021 for any contracts where transition is viable. For tough legacy contracts, regulatory guidance applicable for UK regulated firms is expected in the near future and FCMB UK will take necessary action as required.

16 - What do I need to consider for loans subject to interest rate hedging?
Some clients may have LIBOR-linked loans or other cash transactions hedged with LIBOR derivatives. In that case you may benefit from aligning the transition dates of related transactions. We would recommend you consult with your hedge provider to ensure the reference rate meet your expectations.

17 - When will you stop offering LIBOR-linked Trade Finance and term loans?
We no longer offer new GBP LIBOR loans, and will cease entering into new USD LIBOR transactions or issuing new USD LIBOR loans by the end of 2021. New contracts agreed and maturing after this date will reference a replacement rate.

18 - Why are you changing your USD product offering before USD LIBOR cessation?
The delayed cessation of USD LIBOR is aimed at facilitating a higher proportion of USD legacy contracts to roll off prior to the June 2023 cessation date. Market liquidity will be shifting to alternative reference rates, and it is in the best interest of clients not to add to legacy contracts to be transitioned. US regulators have been clear that writing new USD LIBOR business must end in December 2021, and the UK regulators expect firms under their supervision to also adhere to international supervisory authorities' guidance with regards to this.

19 - What are the rate choices I will have?
We have been developing our new product offering consistent with regulatory expectation and UK benchmark regulation, focussing floating rate products on ARRs, including term rates where appropriate and compounding in-arrears where necessary. We will also continue to offer Bank of England base rate for GBP loans and mortgages, as well as fixed rates.

20 - When will you offer new term rate contracts and for which benchmarks?
We will offer term rates for alternative reference rates, as we develop our new product offering in line with UK Benchmark Regulation. After the official ARRC endorsement of Term SOFR, we anticipate offering Term SONIA and Term SOFR for selected products, and will continue to offer EURIBOR linked products with suitable fallback provisions.

21 - What about overdraft interest?
Where overdraft or default interest terms are linked to LIBOR benchmarks, we will transition to applicable alternative reference rates in line with industry practice. We will be liaising with clients on applicable new terms, including proposed alternative rate and applicable spread adjustment.

22 - When will my existing contracts be changed to new rates?
We expect to transition all GBP LIBOR contracts in line with the regulatory timelines in 2021 and are ready to discuss transition of legacy contracts in all LIBOR currencies with clients. We anticipate existing USD LIBOR

contracts beyond June 2023 to transition closer to the USD LIBOR cessation date, as USD market and products continue to evolve.

23 - Will you actively transition or apply fallback language?
We are planning to discuss with the impacted clients the preferred course of action appropriate to their contracts and expect requests for active transition.

24 – I have further questions.
Please do not hesitate to contact your Relationship Manager who will be pleased to assist.