BENCHMARK RATE REFORM

FREQUENTLY ASKED QUESTIONS
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Contents

Introduction

Benchmark Rate Reform refers to the global, ongoing initiative to analyse, review, enhance and in some cases, replace, major financial benchmarks over time, in addition to the increased regulation of the administrators, contributors and users of those benchmarks.

The financial benchmarks at the centre of the global discussion are Interbank Offered Rates (IBORs), which play a central role in financial markets, and act as reference rates to hundreds of trillions of dollars in notional amount of derivatives and trillions of dollars in bonds, loans, securitisations and deposits[1].

The purpose of these Frequently Asked Questions is to raise awareness with respect to the nature of the transformation underway and expected timelines, with a focus on the transition away from IBORs to alternative reference rates, and to help answer any questions you may have about that process. The document also provides references to key resources, information and websites designed to address this topic in detail.

1 https://www.isda.org/a/OqrEE/IBOR-Transition-Report.pdf

Q1 What is Benchmark Rate Reform?

There are two main components to Benchmark Rate Reform:

1. The analysis, review and enhancement, or possible replacement of, major benchmarks over time;
2. Regulation and codes of conduct aimed at ensuring the integrity and accuracy of existing benchmarks and ongoing supervision of benchmarks by national competent authorities

This document focuses on (1) but question Q11 provides an overview of (2).

Q2 What are the drivers of Benchmark Rate Reform?

In 2014, the Financial Stability Board (FSB), a group composed of global regulators, undertook a review of major interest rate benchmarks such as EURIBOR, LIBOR and TIBOR[2]. In a paper entitled Reforming Major Interest Rate Benchmarks, the FSB made recommendations relating to measures to strengthen existing benchmarks and other potential reference rates based on interbank markets, as well as developing alternative, nearly risk-free reference rates.

Based on the recommendations of the 2014 FSB Report, measures were implemented to strengthen and reform IBORs. One of the objectives of the reform efforts was to ensure LIBOR rates were adequately reflective of, and anchored in, actual transactions in the market. Despite these efforts, however, the sustainability of the rates was called into question due to the significant decline in the underlying transactions in the market underpinning those benchmarks.

Working groups established in each of the jurisdictions related to the major currencies of IBOR (US, UK, EU, Switzerland and Japan) sought to find alternative reference rates. A speech by Andrew Bailey in July 2017[3] set a timeline for transition away from LIBOR, explaining that an agreement had been made with panel banks to voluntarily sustain LIBOR for a four to five year period (until end-2021), and that at the end of that period, the FCA would no longer compel or oblige banks to make submissions to support LIBOR.

2 Reforming major interest rate benchmarks http://www.fsb.org/2014/07/r_140722/

3 https://www.fca.org.uk/news/speeches/the-future-of-libor

Q3 Which benchmarks are involved?

Benchmark Rate Reform discussions are largely centred around the London Interbank Offered Rate (LIBOR), a short-term interest rate that provides an indication of the average rates at which banks could obtain wholesale, unsecured funding for set periods in particular currencies.

LIBOR is produced for five currencies (CHF, EUR, GBP, JPY and USD) and in seven tenors (Overnight/Spot Next, 1 Week, 1 Month, 2 Months, 3 Months, 6 Months and 12 Months) based on submissions from a reference panel of between 11 and 16 banks for each currency, resulting in the publication of 35 rates every applicable London business day.

In Canada, the Canadian Alternative Reference Rate (CARR) working group was created by the Bank of Canada to identify a Canadian dollar term risk-free rate benchmark that is robust, reliable, and resilient to any market stress, that is consistent with the IOSCO Principles for Financial Benchmarks, and that is compliant with any applicable regulations.

In July, 2018, CARR selected an existing Canadian overnight risk-free rate, the Canadian Overnight Repo Rate Average (CORRA), as the risk free alternative to CDOR[4]. More recently, a consultation paper was published by the group on proposed enhancements to CORRA[5]. The Bank of Canada held a series of roundtables, open to all market participants, to discuss the proposed, revised methodology for CORRA. The Bank of Canada would like a broad response to this consultation from a broad array of current and potential users of Canadian interest rate benchmarks, such as banks, broker-dealers, non-financial corporations, pension funds, and asset managers.

Q4 How will the transition to new benchmarks work?

RFRs have now been established in each of the jurisdictions where currencies of LIBOR exist (see appendix for summary of RFRs in each major jurisdiction). RFRs have been developed and introduced, reformed and reintroduced, or are in the process of being developed and will be introduced in the coming months or years. For example, the alternative RFR for USD LIBOR was created in 2017 and introduced to the market in 2018. In the UK, SONIA, the RFR for GBP LIBOR was reformed and reintroduced to the market in 2018.

4 https://www.bankofcanada.ca/markets/canadian-alternative-reference-rate-working-group/

5 https://www.bankofcanada.ca/2019/02/bank-canada-publishes-canadian-alternative-reference-rate-working-groups-consultation-paper/

In addition, not all markets will abandon their IBOR rates. For the moment, we expect CDOR to continue being available in the market concurrently with the alternative overnight rate, CORRA.

In LIBOR jurisdictions, however, where it is expected the rate will be discontinued, a wholesale transition to the RFR is contemplated, and regulators are encouraging firms to use RFRs in place of LIBOR as a means of effectively transitioning away from LIBOR.

There are a number of factors which contribute to the success of this transition:

- Growing **liquidity** in products referencing RFRs, and the ability of firms to adapt systems, models and processes to facilitate a move to the new rates
- The ability of the industry to come to consensus on **transition methodology, fallback language and trigger language for legacy contracts**
- The ability of **market infrastructure** (trading venues, CCPs etc.) to incorporate the RFRs into existing systems and processes

The process for transition may vary according to the RFR, product type or market, and risk could be introduced if transition happens at different times for different rates, product types or market.

Q5 How will legacy contracts be affected?

If some benchmarks cease to exist at a point in the future, any contracts referencing that benchmark that have a maturity beyond the point of discontinuation will need to be given on how to transition to a new benchmark and when that transition occurs. RFRs are unlikely to exactly replicate the economics of IBOR rates, because IBORs incorporate two key elements that the RFRs do not: a) a term structure, and b) a credit spread. The overnight rates that have been chosen as RFRs in each jurisdiction reflect a rate at a point in time, and are based on actual transactions in the underlying market.

The way in which legacy contracts are handled will depend on the nature of the product and mechanisms available in each case to ensure the contract "falls back" to the RFR selected by the parties. In the case of the derivatives market, the International Securities and Derivatives association (ISDA) has been working with the industry to formulate a transition methodology to RFRs that is streamlined, and minimizes the economic impact of falling back from an IBOR rate to an RFR. ISDA is in the process of publishing a series of consultations on the topic and seeking industry feedback on the best way to approach this methodology. The consultations set out options for adjustments that would apply to the fallback rate in the event an IBOR is permanently discontinued[6]. Additionally Bloomberg provided some data analysis to illustrate the effects of different approaches to the transition methodology[7]. This is discussed in more detail below.

Q6 What is fallback language or trigger language in relation to financial contracts?

As discussed above, where benchmarks such as LIBOR are discontinued, contracts that have a maturity beyond the point of discontinuation need to be assessed for the impact on payment obligations that are based on LIBOR. Where a rate can no longer be used, there will be a "triggering" event that will cause the discontinuation. For the derivatives market, those triggers have been proposed as follows (see excerpt from ISDA website on possible triggers):

1. A public statement by the supervisor of the relevant IBOR administrator of the insolvency of such IBOR administrator (and there is no successor administrator that will continue publication of the relevant IBOR);
2. A public statement by the relevant IBOR administrator that it will cease publishing the relevant IBOR permanently or indefinitely (and there is no successor administrator that will continue publication of the relevant IBOR);
3. A public statement by the supervisor for the relevant IBOR administrator that the relevant IBOR has been permanently or indefinitely discontinued; or
4. A public statement by the supervisor for the relevant IBOR administrator that the relevant IBOR may no longer be used.

Once the triggering event has occurred, fallback provisions would be invoked.

The trigger for implementing the fallback provision may be either the cessation of the original benchmark or some event indicating that the benchmark will either become unavailable at some point in the future,

6 https://www.isda.org/2018/12/20/benchmark-fallbacks-consultation/

7 http://assets.isda.org/media/8d902403/99707168-pdf/

or an event indicating that the rate has become unrepresentative of market conditions (pre-cessation). Pre-cessation triggers have been discussed more broadly in discussions referencing cash market contracts.

Q7 Is there a standard approach to fallback language or trigger language?

Historically, many financial contracts have contemplated the possibility that a benchmark may be unavailable, but more in the context of an outage of benchmark rate data for a temporary period of time, rather than a permanent cessation.

Consultations have been published by various industry bodies in relation to specific products types to gather industry feedback aimed at converging on standardized language both for the rate to which the contract will fallback, and the trigger for when the fallback language will take effect. There are differences in the approach to fallback language dependent upon the product type and nature of the contract.

Derivatives

It is expected that counterparties to ISDA-based derivatives contracts based on LIBOR and other IBOR rates will be able to sign an ISDA protocol (once released later in 2019) that will allow for all relevant terms pertaining to the fallback rates and methodologies applicable to those rates to be incorporated into the existing IBOR-based contracts. By virtue of the protocol, if adopted by the parties, all relevant adjustments will be made to the contract to accommodate the differences between IBORs and the fallback RFRs.

Cash Products

The US working group, the Alternative Reference Rates Committee (ARRC) has taken the lead gathering industry feedback on the preferred approach to fallback language for cash products. Consultations have been published related to several cash products (floating rate loans, syndicated loans, bilateral loans, and securitisations)[8]. Based on those consultations, the ARRC published its recommendations for More Robust Contract Language for New Issuances of USD LIBOR based Syndicated Loans and Floating Rate Notes[9] on April 25, 2019.

8 https://www.newyorkfed.org/arrc/fallbacks-contract-language

9 https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/FRN_Fallback_Language.pdf, https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Syndicated_Loan_Fallback_Language.pdf

These recommendations outline draft language parties may consider putting into new contracts that reference USD LIBOR to ensure these contracts will continue to be effective in the event that LIBOR is no longer usable. In some cases, the use of the ARRC's recommended language will still require amendments to those the agreements, according to the terms, as a means of settling on the applicable RFR along with any adjustments thereto.

Additionally, regional trade associations such as the Loan Syndicated and Trade Association and the Loan Market Association have been working with the industry to raise awareness of changes required in the cash markets and to gather industry feedback on the preferred approach[10].

Q8 What can firms do now to prepare for the potential cessation of certain benchmark rates?

Global trade associations joined together in 2017 to produce some guidance to complement the effort led by the global regulators and the RFR working groups. They produced a Global Benchmark Transition Roadmap[11] published in Feb 2018 (the Roadmap), commissioned a Global IBOR Market Survey, and published the results of the survey in the IBOR Global Benchmark Transition Report[12] in July 2018 (the Report).

The Roadmap provides an overview of the background and drivers behind benchmark rate reform, aggregates information published across regulatory bodies and the working groups, and aimed to raise market awareness of the transition challenges identified at the time.

The Report provides feedback from over 150 firms across 24 countries as to general awareness of the topic of transition away from IBORs, the challenges identified and also aggregates other publicly available information which may be helpful to market participants as they address their exposure to IBORs. It provides a checklist of tasks which firms may want to consider in preparing for transition.

10 https://www.lsta.org/news-and-resources/news/libor-fallbacks-syncing-loans-and-clos ; https://www.lma.eu.com/libor

11 https://www.isda.org/a/g2hEE/IBOR-Global-Transition-Roadmap-2018.pdf

12 https://www.isda.org/a/OqrEE/IBOR-Transition-Report.pdf

Q9 When will market infrastructure develop to incorporate the new rates?

The level of maturity of market infrastructure to develop new processes and systems in response to progress of benchmark rate reform differs across markets and relating to the maturity of the reference rate in each jurisdiction.

London Clearing House (LCH) published a statement in support of ISDA's recommended benchmark fallback approaches[13] and it has been reported that LCH intends to move towards SOFR discounting in 2020[14].

Q10 What have been identified as the key risks to firms associated with a transition to alternative reference rates?

The ISDA IBOR Global Benchmark Transition Report referenced above highlights the major challenges associated with transitioning to RFRs, such as financial impacts, contractual challenges with respect to fallback and trigger language, and general awareness, both internally and in relation to clients. Furthermore the report outlines challenges with regards to tax and accounting, regulatory risks, and the management of internal risk.

Q11 What measures are the regulators taking in each jurisdiction?

In addition to the working groups (summarised in Fig. 1 in the appendix), regulators have also put in place measures to ensure the integrity and accuracy of existing benchmarks and ongoing supervision of benchmarks by national competent authorities. Regulators have also voiced their support for the transition to RFR:

Canada

The Canadian Securities Administrators (CSA) published for comment a proposed rule, National Instrument 25-102 Designated Benchmarks and Benchmark Administrators (Proposed NI 25-102) on March 14, 2019[15].

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13 https://www.lch.com/membership/ltd-membership/ltd-member-updates/lchs-position-respect-isdas-recommended-benchmark

14 https://www.risk.net/derivatives/6385026/lch-plans-2020-switch-to-sofr-discounting

15 https://www.securities-administrators.ca/aboutcsa.aspx?id=1777

Proposed NI 25-102, if passed, would require benchmark administrators, contributors and users of certain benchmarks to have procedures and plans in place to deal with the cessation of critical benchmarks such as IBORs.

Europe

The European Securities and Markets Association (ESMA) enacted the EU Benchmark Regulation on June 29, 2016 to regulate the administration and use of critical benchmarks in the EU[16].

United States of America

The Board of Governors of the Federal Reserve have introduced weekly open office hours to provide market participants with regular opportunities to ask questions on key IBOR transition issues[17].

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16 https://www.esma.europa.eu/policy-rules/benchmarks

17 https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-Feb-12-2019-announcement.pdf

Appendix

Fig. 1 Summary of Alternative Reference Rates by jurisdiction in each major currency

IBOR			Alternative Reference Rate					
IBOR	**Relevant working group**	**Expected date of IBOR discontinuation**	**RFR**	**Reference rate based on:**	**Secured or unsecured**	**Date RFR selected**	**RFR in use**	**Date of first publication of RFR**
USD LIBOR	Alternative Reference Rates Committee (ARRC)	End of 2021 *(expected)*	Secured Overnight Financing Rate **(SOFR)**	Borrowing rates for treasury backed deposits and repos	Secured Administrator: New York Federal Reserve Bank	June 2017	Yes	April 3, 2018
GBP LIBOR	Working Group on Sterling Risk-Free Rates	End of 2021 *(expected)*	Sterling Overnight Interbank Average Rate **(SONIA)**	Weighted average of unsecured overnight Sterling transactions	Unsecured Administrator: Bank of England	April 2017 (Reformed SONIA)	Yes	April 23, 2018 (reformed rate)
CHF LIBOR	Swiss National Working Group	End of 2021 *(expected)*	Swiss Average Overnight Rate **(SARON)**	Transactions and quotes published in the Swiss repo market	Secured Administrator: SIX Exchange	October 2017	Yes	2009
EUR LIBOR EURIBOR EONIA	Working Group on Euro Risk-Free Rates	**EONIA** January 3, 2022 **EUR LIBOR** End of 2021 **EURIBOR** Needs to be reformed by January 2022	Euro Short Term Rate **(€STR)**	Overnight unsecured fixed rate deposits	Unsecured Administrator: European Central Bank	May 2018	No	October 2, 2019
JPY LIBOR JPY TIBOR	The Study Group	**JPY LIBOR** End of 2021 *(expected)* **JPY TIBOR** Reform completed 2017	Tokyo Overnight Average Rate **(TONA)**	Volume weighted average of unsecured deposits	Unsecured Administrator: Bank of Japan	December 2016	Yes	1996
CDOR	Canadian Alternative Reference Rates Working Group (CARR)	Enhancement only, unlikely to be discontinued	Canadian Overnight Repo Rate **(CORRA)**	Volume weighted average of overnight repo transactions	Secured Administrator: Thomson Reuters	July 2018	Yes	1997

Data as of March 31, 2019.

Summary of External References

1. The Intercontinental Exchange (ICE) - LIBOR administrator page on Transforming Global Benchmarks: https://www.theice.com/iba

2. The US Working Group, the Alternative Reference Rates Committee: https://www.newyorkfed.org/arrc

3. The Canadian Securities Administrators webpage about the proposed Canadian Benchmark Regulation: https://www.securities-administrators.ca/aboutcsa.aspx?id=1777

4. The European Securities and Markets Association webpage about the EU Benchmark Regulation: https://www.esma.europa.eu/policy-rules/benchmarks

5. Federal Reserve Open Office Hours Announcement: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-Feb-12-2019-announcement.pdf

6. FCA Dear CEO letter details: https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-firms-transition-from-libor-insurers.pdf

7. The LCH position with respect to ISDA's recommended Benchmark Fallback Approaches: https://www.lch.com/membership/ltd-membership/ltd-member-updates/lchs-position-respect-isdas-recommended-benchmark

8. ARRC fallback language page: https://www.newyorkfed.org/arrc/fallbacks-contract-language

9. The LSTA page on LIBOR fallbacks: https://www.lsta.org/news-and-resources/news/libor-fallbacks-syncing-loans-and-clos

10. The LMA page on LIBOR: https://www.lma.eu.com/libor

11. The ISDA Global Benchmark Transition Roadmap: https://www.isda.org/a/g2hEE/IBOR-Global-Transition-Roadmap-2018.pdf

12. The ISDA Global Benchmark Transition Report: https://www.isda.org/a/OqrEE/IBOR-Transition-Report.pdf

13. The ISDA Benchmark Fallbacks Consultation: https://www.isda.org/2018/12/20/benchmark-fallbacks-consultation/

14. Bloomberg Illustration of the four approaches to adjusted RFRs and three spread adjustment methodologies:
http://assets.isda.org/media/8d902403/99707168-pdf/

15. FSB progress report 'Reforming Major Interest Rate Benchmarks'
http://www.fsb.org/wp-content/uploads/P141118-1.pdf

16. The Canadian Working Group, The Canadian Alternative Reference Rates Committee:
https://www.bankofcanada.ca/markets/canadian-alternative-reference-rate-working-group/

17. The CARR Working Group Consultation paper:
https://www.bankofcanada.ca/2019/02/bank-canada-publishes-canadian-alternative-reference-rate-working-groups-consultation-paper/

18. The initial FSB report, 'Reforming major interest rate benchmarks' 2014:
http://www.fsb.org/2014/07/r_140722/

19. The transcript from the Andrew Bailey speech in July 2017:
https://www.fca.org.uk/news/speeches/the-future-of-libor