ING

IBOR transition
Frequently asked questions

The purpose of this FAQ is to inform our clients of the recent and upcoming developments about the transition of interest rate benchmarks.

This guide is not intended to be, and should not be relied upon as legal, financial, tax, accounting or other advice. You should consult your advisors for advice on the risks and challenges related to the reform of interest rate benchmarks. This FAQ is not intended to address all the financial and other risks that may arise regarding the interest rate benchmark transition.

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General

1. Why are some interest rate benchmarks being reformed or discontinued?

Financial markets have changed significantly since the global financial crisis. One key development is that banks no longer fund themselves in the interbank market to the same extent. This is one of the key drivers for the reform of some Interbank Offered Rates (IBORs) and the development of alternatives. To illustrate the issue for LIBOR, the former chief executive of the Financial Conduct Authority (FCA) has referred to LIBOR as 'measuring the rate at which banks are not borrowing from one another' to highlight the growing risk of it no longer being representative.

In 2013, the International Organisation of Securities Commissions (IOSCO) introduced a set of principles underpinning the calculation of a benchmark rate. In 2014, the Financial Stability Board (FSB) published a report called 'Reforming Major Interest Rate Benchmarks' which sets out recommendations, developed under the guidance of the Official Sector Steering Group (OSSG). The recommendations included measures to:

- Strengthen IBORs by anchoring them to a greater number of transactions, where possible;
- Improving the processes and controls around submissions;
- Identifying alternative near Risk Free rates (RFRs);
- Encouraging derivative market participants to transition new contracts to an appropriate RFR, where suitable.

Besides these recommendations, the report discusses transition issues and how the market adoption of these recommendations will be monitored in the period ahead. The European Union (EU) followed with the introduction of the Benchmark Regulation (BMR), which incorporates a fundamental principle that benchmarks, including IBORs, need to be based on actual transactions to the fullest extent possible.

ICE Benchmark Administration (IBA), as the administrator of LIBOR, has reformed the methodology of LIBOR to a more transaction-based one. However, the number of underlying transactions in the interbank market has fallen and as a result, the calculation under the reformed methodology is still reliant on the expert judgment of the LIBOR panel banks. The FCA has agreed with the panel banks that they will continue making submissions until the end of 2021, at which point some banks may withdraw from the LIBOR setting process. There is a possibility that if too many banks withdraw, it will not be feasible to produce a LIBOR rate that appropriately reflects an underlying market. Whilst no panel bank has publicly stated that they will not continue to contribute beyond this date, the FCA have stated that the market must prepare for this eventuality.

Financial markets participants are therefore working on a transition process to avoid risking a disorderly discontinuation of rates subject to transition. Please refer to the latest report for further details on the transition to more robust financial benchmarks across multiple jurisdictions.

2. What are the alternative reference rates?

Market participants and industry bodies have put in a significant amount of effort to find a way to either reform existing benchmark rates or, alternatively, to develop replacements that meet regulatory requirements. The outcome is a set of alternative rates based on overnight transactions, which are deigned to be representative of a nearly risk free rate.

They are frequently referred to as Risk Free Rates (RFR). Below is an overview of the recommended alternative rates per LIBOR (London Interbank Offered Rate) currency.

Jurisdiction	Working Group	(Alternative) Reference Rate	Nature	Description
Euro area	Working group on euro risk-free rates	Euro short-term rate (€STR)	Unsecured	Unsecured rate that captures overnight wholesale deposit transactions
United Kingdom	Working Group on Sterling Risk-Free Reference Rates	Sterling Overnight Index Average (SONIA)	Unsecured	Unsecured rate that covers overnight wholesale deposit transactions
United States of America	Alternative Reference Rates Committee (ARRC)	Secured Overnight Financing Rate (SOFR)	Secured	Secured rate that covers multiple overnight repo market segments
Switzerland	The National Working Group on Swiss Franc Reference Rates	Swiss Average Rate Overnight (SARON)	Secured	Secured rate that reflects interest paid on interbank overnight repo rate
Japan	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks	Tokyo Overnight Average Rate (TONAR)	Unsecured	Unsecured rate that captures overnight call rate market

3. What are some of the challenges of using risk free rates?

LIBOR is a forward-looking or 'term' rate quoted for five currencies (USD, GBP, CHF, JPY and EUR) and seven tenors (overnight/spot, one week, one month, two months, three months, six months and 12 months). Hence, the LIBOR-linked rate in a contract is known at the start of the relevant interest period.

All the RFRs are overnight rates and therefore the rate is not known in advance. One approach to create a term rate from these overnight rates is on a backward-looking basis. The backward-looking term rate can be constructed by calculating a simple or compounded average of the daily fixings of the RFR over the given term. This means that the determination and accounting for a three-month or six-month rate based on RFRs requires significantly different mechanics.

4. What are the plans for forward-looking term risk-free rates?

The working groups are reluctant to encourage unnecessary reliance on forward-looking rates based on the selected risk-free rates. Consequently, various national RFR Working Groups have stated that any forward-looking term rates that may become available are only intended for use in certain products or in certain circumstances.

The Sterling RFRWG has established a Term Rate Task Force, with the current ambition to have a forward rate available in Q4 2020. The Alternative Reference Rates Committee in the US ("ARRC") has included the production of a forward-looking term rate as one of the final steps of its Paced Transition Plan, with the latest plan indicating that such a rate may become available in Q2 2021. The expected publication of the forward-looking term version of TONAR (for Japanese Yen) is around mid-2021. The Swiss RFR Working Group has expressed their intention to proceed without a forward-looking term rate based on SARON.

Derivative products

5. How is ISDA approaching LIBOR's expected demise regarding a replacement rate?

ISDA has conducted a number of consultations to help determine the transition journey for the derivatives markets. The key questions are what replacement rate and spread adjustment to use and when such fallbacks will be triggered. A spread adjustment is needed to account for the fact that IBORs incorporate a bank credit spread and liquidity premium whereas RFRs do not.

To create a replacement rate, the term adjustment will be based on the "compounded setting in arrears rate", where the relevant Alternative Reference Rate (ARR) is observed over the relevant IBOR term and compounded daily during a two-day shifted period. The spread adjustment will be the "historical median approach" based on the median spot spread between the IBOR and the adjusted ARR calculated over a five-year lookback period prior to the relevant announcement. The fallback rate will equal the term-adjusted ARR plus the spread adjustment.

Even with spreads or other adjustments, ARRs used as fallbacks may be only an estimate or approximation of the relevant IBOR, may not be subject to continued verification against the relevant IBOR and may not result in a rate that is the economic equivalent of the specific IBOR. In addition, any spread adjustment that becomes fixed as a consequence of discontinuation of the relevant IBOR, may reflect a historical behaviour of the relevant rates without taking into account future changes in the unsecured short-term funding costs of banks.

ISDA has selected Bloomberg Index Services Limited (BISL) to calculate and publish the fallback rates. For the indicative IBOR fallback rates, please refer to Bloomberg LIBOR-transition page. For more information, please refer to ISDA's website: Benchmark Reforms and Transition from LIBOR.

6. What is ISDA's approach to defining a trigger event?

The relevant RFR and the spread adjustment will be considered as fallback after the relevant IBOR ceases to exist. This is typically when the benchmark administrator announces that the benchmark will no longer be published, i.e. the rate is no longer available. This announcement could apply to all tenors in a specific currency, or may be limited to a specific tenor in that currency.

For derivatives that reference LIBOR, an additional trigger is added. The adjusted RFR will also be a fallback if the FCA determines that LIBOR (in that currency and tenor) is no longer representative of its underlying market, even if the rate continues to be published.

7. How and when will the ISDA changes to IBOR fallbacks be implemented?

ISDA published the long-awaited updated IBOR Fallback Supplement (IBOR Supplement) to the 2006 ISDA Definitions on 23 October 2020, with effective date on 25 January 2021. The IBOR Supplement amends the 2006 ISDA Definitions to incorporate robust fallbacks for derivatives referencing relevant IBORs[1], with the changes coming into effect on 25 January 2021. From that date, all new derivatives that reference the 2006 ISDA Definitions will include the fallbacks of the IBOR Supplement.

[1] Relevant IBORs include LIBOR for all five currencies; the Euro Interbank Offered Rate ("Euribor"); the Tokyo Interbank Offered Rate ("TIBOR," which comes in on-shore (Japanese yen) and off-shore (euroyen) varieties); the Australian Dollar Bank Bill Swap Rate ("BBSW"); the Canadian Dollar Offered Rate ("CDOR"); the Hong Kong Interbank Offered Rate ("HIBOR"), the Singapore Dollar Swap Offer Rate ("SOR"), and the Thai Baht Interest Rate Fixing ("THB-SOR".

Simultaneously with the IBOR Supplement, ISDA also published the 2020 ISDA IBOR Fallback Protocol (IBOR Protocol) for market participants who wish to incorporate the IBOR Supplement into their derivatives they entered into before 25 January 2021.

A protocol is a multilateral contractual amendment mechanism that is used to make standard amendments to ISDA documentation among adhering counterparties. It is an efficient way of implementing industry standard contractual changes to legacy trades with a large number of adhering counterparties, while avoiding the need to negotiate the same amendments with each party individually.

Participants that wish to incorporate the IBOR Supplement will be required to complete an adherence process with ISDA. If both parties adhere to the IBOR Protocol, the IBOR fallback triggers and replacement rates will in principle apply to all trades between them referencing relevant IBORs and executed under a covered Master Agreement. Please refer to the register on the ISDA site.

ING Bank N.V. has registered it's adherence to the IBOR protocol in line with the recommendations of various industry bodies and working groups. ***Please note that the ISDA IBOR fallback provisions may not be compatible with certain transactions (such as non-linear derivatives) or may not align with the fallback terms in related cash products (for example, derivatives used to hedge loans). In such cases, those transactions may need to be specifically excluded when adhering to the protocol.***

It is recommended that parties with outstanding derivatives trades referring to an IBOR assess the benefits of the IBOR Protocol and set out an appropriate plan of action.

If you have any questions about the ISDA IBOR Protocol that are not answered here, we refer to the IBOR FAQ on www.isda.org

Cash & Loan products

8. What will happen to cash products that reference LIBOR and mature after the end of 2021?

Cash products that reference LIBOR and mature after LIBOR is likely to cease to exist (year-end 2021) will need to transition to an alternative benchmark rate for the determination of interest payable on and after the expected cessation date. Such transition and the selection of the replacement or alternative rate may be governed by fallback language in the contract relating to the product. Traditionally, in some contracts the fallback provisions are designed for a temporary cessation and not a permanent cessation. With the move away from LIBOR, fallback provisions designed for a permanent cessation or a process for replacement are required.

Fallback language, if present, typically sets out in the form of a waterfall or an amendment process the steps to determine the replacement rate. Fallback language will typically define a certain "trigger event" which initiates the switch from one benchmark rate to another.

An alternative strategy is to move away from IBORs via what is termed as "active transition" whereby the current product is amended, prior to the cessation of LIBOR, such that the reference to LIBOR is replaced with an alternative benchmark rate that is not reliant on the publication of LIBOR fixings. This method of transition is actively promoted by the working groups.

The UK RFRWG has recently issued guidance on active transition. See here for loans and here for bonds.

These are the steps for loans:

1. Review outstanding GBP LIBOR referencing loans (including multi-currency loans containing a GBP LIBOR option);
2. Identify the alternative reference rate to be used for each loan;
3. Familiarise yourself with how the alternative reference rate will be calculated, and how to calculate any economic difference between GBP LIBOR and the selected alternative rate;
4. Consider whether systems and operations are ready to accommodate alternative reference rates;
5. Document the transition of the loans. All parties should undertake appropriate due diligence on any changes that are proposed.

9. How does the amendment approach differ to a hardwired or switch agreement?

The "amendment approach" provides a process that parties in the negotiation of a benchmark's replacement can follow if a trigger event occurs. The approach itself may not define the benchmark that would apply, but sets out some parameters for its selection.

Alternatively, fallback language can be hardwired, which means that an alternative benchmark rate (or choice of available rates via a waterfall) is built into the facility agreement. This approach provides certainty upfront by defining the trigger events and outlining either a direct replacement or a 'waterfall' approach to determine an RFR-based or other successor rate. Note that current forms of hardwired language would require documentation to be further amended with "conforming changes" in order for the facility agreement to operate with the relevant RFR-based or other successor rate. Conforming amendments are generally implemented by the Agent or Agent and Borrower without lender input.

Rate Switch (or flip) mechanisms in loan documentation are also a form of hardwired fallback but differ from the approach described above in that all the relevant changes which require to be made in the document in order to allow the facility to switch from LIBOR to an RFR are built into the agreement on day one. This means that there is no need for further discussions and amendment at a later stage. Such agreements provide a built-in switch from LIBOR to RFRs upon a specified trigger (or date) and set out the provisions for the use of that rate. This approach requires an upfront consideration of the spread adjustment calculation, RFR convention and documentation issues. The rate switch approach has been agreed on in a number of bespoke syndicated loan transactions in the UK market. The Loan Market Association (LMA) has published a draft of a rate switch agreement, so this approach is expected to become more popular.

Fallback language in most existing loan agreements follows the amendment approach and does not have the replacement benchmark hardwired into it.

The hardwired approach is recommended by the ARRC, who have also published recommended wording, as using the amendment approach may simply not be feasible if thousands of loans must be amended in a short period at the time of LIBOR cessation.

10. What are some of the key issues regarding loan product fallbacks?

Cash market instruments, especially many existing contracts, do not contain appropriate fallbacks. For example, it has been widely noted that for many bonds and securities, the traditional fallbacks would have the effect of them converting to a fixed rate (last published rate) when LIBOR ceases.

For most syndicated loans, each individual loan agreement referencing LIBOR will need to refer to a replacement benchmark rate in order to have a robust fallback. In Europe, the Loan Market Association (LMA) has published an Exposure Draft and a Reference Rate Selection Agreement to help with the LIBOR transition, although this does not constitute a recommendation for any particular form of amendment process.

In terms of fallback provisions in loan agreements, if the benchmark rate for a loan agreement ceases to exist, there is an optional clause (since 2014 with a much more detailed version published in 2018), which can be included in the recommended forms of the LMA loan agreements and which sets out a process for the parties to agree on a replacement reference rate.

In the United States, in the event that US dollar LIBOR is unavailable, most loan agreements fallback to a “base rate” (typically the higher of a banks prime rate and the Federal Funds Effective Rate plus 50 bps). Historically, the base rate has been higher than LIBOR, hence more costly for the borrowers. For other currencies, traditional fallback mechanics include using interpolated rates, reference bank rates or lenders’ cost of funds. All these historical fallback mechanisms were not originally intended to address a permanent cessation of LIBOR.

To address the permanent cessation of LIBOR, the ARRC favours a hardwired approach that does not require a lender vote, making it easier to put into effect upon cessation. The approach has not yet been taken up widely by the market due to operational uncertainties about SOFR-based replacements for USD LIBOR and further complexities with multi-currency facilities. The recommendations by the ARRC for syndicated and bilateral loans promote the ARRC’s best practice to adopt the use of hardwired fallback language (instead of the use of the amendment approach). The hardwired approach for syndicated and bilateral loans recommends the use of Term SOFR. If that is unavailable, then the Daily Simple SOFR (instead of a compounded SOFR-based rate) is recommended in the second step of the waterfall. If no enumerated SOFR-based rate is available, the hardwired approach converts to the amendment approach. More information is available here.

11. What remedies are being considered for legacy financial instruments that have no or inadequate fallback provisions, so called ‘tough legacy’ contracts?

Tough legacy contracts are contracts that have no or inappropriate fallback, or that are not able to realistically be renegotiated or amended.

In March 2020, the ARRC, which is the industry working group leading the transition from USD LIBOR to SOFR, issued a proposal focusing on legacy contracts whose fallback language is most likely to lead to disputes or unintended economic consequences. If a contract has no fallback provision or falls back to a LIBOR-based rate (such as the last available LIBOR rate), the legislation imposes the ARRC's recommended replacement benchmark rate (‘SOFR’) and adjustment spread. This proposal has not been enacted into law, at the time of this FAQ publication.

For contracts where one party is allowed to choose a replacement benchmark, the proposed legislation provides a safe harbour for choosing the ARRC-recommended benchmark rate and adjustment spread. The proposed legislation would also rescind any fallback provisions that require a party to conduct a poll for interbank lending rates. The proposed legislation does not impact fallback provisions that lead to non-LIBOR replacement benchmarks (such as the prime rate) or contracts where the parties mutually agree to 'opt out' of its application.

The Sterling RFRWG set up a Tough Legacy Task Force at the end of 2019. This Task Force has analysed the characteristics of "tough legacy" contracts across asset classes and concluded that there is a case for action to address these exposures. To the extent feasible, the Task Force proposes that the UK Government considers legislation to address "tough legacy". The UK treasury has shown initial support for this request, and issued a statement proposing that the FCA is granted stronger powers to manage an orderly transition for specific cases.

The recommendations are helpful in highlighting both the challenges and the potential solutions to deal with "tough legacy" contracts across both multiple currencies and multiple jurisdictions. The recommendations are also consistent with other efforts to ensure that authorities are suitably equipped. For instance, the European Commission is considering amendments to the EU Benchmarks Regulation to ensure the orderly cessation of a critical benchmark such as LIBOR which includes the power to mandate the continued provision of LIBOR using a different methodology.

There is no guarantee that either of the above solutions will materialise (in time, across all relevant legal jurisdictions, or available for all products and circumstances). It is also recognised that such alternative potential solutions may not succeed, be economically neutral, or suitable for particular contracts.

Hence, market participants should continue their efforts to actively transition away from LIBOR before the end of 2021 noting that there may be legislative solutions which provide relief for a limited number of legacy products.

12. What are the Working Groups considering as a recommended replacement rate for LIBOR cash products?

The Alternative Reference Rates Committee (ARRC) and the Sterling RFRWG are both looking to establish a recommended replacement rate in fallback clauses.

In the United States, USD LIBOR is widely expected to be replaced by SOFR, the Secured Overnight Financing Rate, for most cash products. SOFR is based on overnight U.S. Treasury repurchase transactions (repo transactions) – essentially loans secured by U.S. Treasuries. It is not a forward-looking rate and it does not have a credit component, unlike interbank offered rates like LIBOR.

In the UK, Sterling LIBOR will be replaced by SONIA. Like SOFR, SONIA is not a forward-looking rate and it does not have a credit component either.

In order to best preserve the economics, a spread adjustment reflecting the difference between LIBOR and the new benchmark must be included. Both the ARRC and Sterling RFRWG see the benefits of using the five-year lookback approach set out by ISDA as the basis for this spread adjustment to the alternative rate for cash products.

For example, following a consultation on credit adjustment spread methodologies, the Sterling RFRWG recommends the use of the historical five-year median spread adjustment methodology (also referred as “ISDA historical median approach”) when calculating the credit adjustment spread. This should then be applied to the SONIA rate which is chosen or recommended to replace the GBP LIBOR. For more information refer to question 17.

The ARRC also recommends a spread adjustment methodology based on the historical median over a five-year lookback period calculating the difference between USD LIBOR and SOFR consistent with the methodology recommended for derivative products. This approach helps align the spread-adjusted SOFR used in cash products with any related hedging positions. The ARRC additionally recommends a one-year transition period for consumer products to mitigate a “cliff effect” (the difference in the spread at the time of cessation compared to the 5 year historical median) that could result from the LIBOR transition. For more information refer to question 14.

13. Where is the LIBOR loan market heading? What are various Working Groups working on?

The existing conventions and operations in the LIBOR loan market are based on rates that are fixed at the start of each interest period. Because the proposed new benchmarks do not naturally have a term structure, like LIBOR, regulators and Working Groups have made it clear that they expect the loan market to be able to move to interest determined in arrears and that market participants should not wait for forward-looking term rates to become available before transitioning to alternative rates. The working groups, however, have acknowledged that there are a limited number of products such as receivables financing, where it may be preferable to use a forward-looking term RFR rate, as the discounted amount is required to be determined upfront.

Moving to calculation of interest in arrears will mark a significant change in loan operations for banks, agents and borrowers. For example, an agent will only be able to notify a borrower of the amount of interest to be paid towards the end of the interest period. To support the market in the transition, the Loan Market Association (LMA) has produced an exposure draft for new loans where interest is compounded in arrears and the draft rate switch agreement referred to above also incorporate the mechanics and conventions for calculation of interest compounded in arrears. The LSTA has similarly produced concept draft credit agreements where interest is either daily simple SOFR in arrears, or daily compounded SOFR in arrears.

The sterling working group have made it clear that they expect market participants to stop offering cash products based on GBP LIBOR by the end of Q1 2021. Please refer to question 18 for further details. The ARRC has also issued target dates, with a similar intent, which are summarised in question 15.

Transition USD LIBOR

14. What guidance and tools are available for the transition from USD LIBOR to SOFR?

To facilitate the adoption of SOFR in consumer and other cash products, the Federal Reserve Bank of New York has published since 2 March 2020: 1) a **SOFR Index** to measure the cumulative impact of compounding on a unit of investment over time, with the initial value set to 1 on 2 April 2018, the first value date of SOFR; and 2) **SOFR compounded averages** over rolling 30-, 90-, and 180-calendar day periods. The SOFR Index value reflects the effect of compounding SOFR each business day and allows the calculation of compounded SOFR rates over custom time periods. The SOFR Index and Averages could be referenced in a variety of products and as a result, the publication ("one golden source") is intended to help accelerate the transition away from USD LIBOR. The SOFR Index and Averages are published daily on the Federal Reserve Bank of New York's website.

However, the specific conventions for and characteristics of many syndicated business loans may make the existing SOFR Index less useful for syndicated business loans. The existing SOFR Index is a compounded index, so it is not applicable to Daily Simple SOFR Loans. The SOFR Index also requires an observation shift, which is not the recommended convention for syndicated business loans, and it also does not work well with optional prepayments and interest rate floors, both common features in commercial loans.

The Alternative Reference Rates Committee (ARRC) has recently issued requests for proposals seeking a potential administrator to publish forward-looking SOFR term rates, as well as a firm to publish daily indicative spreads.

In addition, the ARRC has produced a number of tools that can help to facilitate the transition away from USD LIBOR including:

- Frequently Asked Questions;
- A practical implementation checklist for SOFR Adoption, which is developed as an informational document for market participants.
- A Users Guide to explain how those unfamiliar with overnight rates can use SOFR in cash products. The User's Guide covers a number of conventions, including simple versus compound averaging; in arrears versus in advance payment structures; and lookback, payment delay, and lockout conventions for providing payment notice.
- SOFR Starter kit, a set of factsheets to inform the public about the transition away from USD LIBOR to SOFR. The SOFR Starter Kit includes background on the impetus for the transition and the ARRC's work to select a preferred rate, facts and figures about SOFR, and next steps market participants can take.

The ARRC has also released recommended contractual fallback language for new USD LIBOR denominated bilateral business loans, which are broadly consistent with conventions proposed for syndicated loans issued on 22 July 2020. The hardwired approach has been updated to recommend the use of Daily Simple SOFR in the second step of the waterfall consistent with the recommended hardwired approach for syndicated loans. The hedged loan approach uses the ISDA IBOR fallback approach to ensure alignment with the related derivative(s).

15. What timetables and targets are in place for the transition to SOFR?

In May 2020, the Alternative Reference Rates Committee (ARRC) published recommended best practices to assist market participants in all jurisdictions, as they prepare for the cessation of USD LIBOR. The ARRC's recommended best practices are intended to clarify the timelines and interim milestones that the ARRC believes are appropriate for transitioning away from USD LIBOR in a way that will minimise market disruption and support a smooth transition through the broad voluntary adoption of SOFR.

These recommended timelines and intermediate steps include;

1. New USD LIBOR cash products should include ARRC recommended (or substantially similar) fallback language as soon as possible.
2. As the ARRC has previously noted, third-party technology and operations vendors relevant to the transition should complete all necessary enhancements to support SOFR by the end of 2020.
3. New use of USD LIBOR should stop, with timing depending on specific circumstances in each cash product market. One notable target is no new USD LIBOR business loans maturing after 2021 should be originated after **30 June 2021**.
4. For contracts specifying that a party will select a replacement rate at their discretion following a LIBOR transition event, the determining party should disclose their planned selection to relevant parties at least six months prior to the date that a replacement rate would become effective.

Detailed timelines are provided on a product-by-product basis which can be found here. In addition, please refer to the ARRC's paced transition plan with specific steps and timelines designed to encourage adoption of SOFR.

16. Are some USD LIBOR dependent products already transitioning to using SOFR?

Market practices are still developing in the loan market, however it does seem likely that some sectors will use daily simply SOFR, and others compounded SOFR (especially if there is a hedging requirement).

Although USD LIBOR remains dominant, SOFR cash and derivatives markets have begun to grow:

- Since SOFR's publication, a notional $601bn in floating rate instruments tied to SOFR have been issued, with a notional of over $458bn outstanding notional at April month-end; please refer to ARRC's April-May newsletter for further details.
- There is a steady increase in the volume of SOFR futures trades.
- Options on one-month and three month SOFR Futures have started trading; please refer to CME Group's website for further details on options on SOFR Futures.
- In December last year, one of the first revolving credit facilities linked to SOFR was signed.
- The World Bank (International Bank for Reconstruction and Development, IBRD) recently issued a USD 700 million seven year benchmark bond linked to the SOFR index. Of particular note is that the index convention used is the SOFR index as published by the NY Fed and the coupon convention is Compounded SOFR. Also, a five day observation period shift was used to facilitate the use of the SOFR index.

Transition GBP LIBOR

17. What guidance and tools are available for the transition from GBP LIBOR to SONIA?

The Bank of England published the SONIA Compounded Index on 3 August 2020 to support the transition from LIBOR to Risk-Free Rates in Sterling markets. The SONIA Compounded Index simplifies the calculation of compounded interest rates and is seen as a standard, official source. Similarly, RFR compounded indices for SOFR and SARON are available on the websites of the New York Fed and SIX respectively.

In September 2020, the Sterling RFRWG released recommendations for conventions for loans based on SONIA compounded in arrears – Conventions for compounded in arrears SONIA. The recommendation stresses that SONIA remains the Working Group's recommended alternative to Sterling LIBOR, implemented via a compounded in arrears methodology, and that loan markets should move consistently towards this. Recommendations include:

- use of a Five Banking Days Lookback (without observation period shift);
- where an interest rate floor is used, it may be necessary to apply the floor to each daily interest rate before compounding;
- accrued interest should be paid at the time of any principal prepayment

In addition, the Sterling RFRWG has produced guidance and tools that can help to facilitate the transition away from GBP LIBOR including:

- A factsheet providing more information on the LIBOR transition;
- Updates on market conventions, such as a statement for bond markets;
- A document on 'lessons learned' from past conversions of legacy LIBOR contracts;
- A document setting out the Sterling RFRWG's views on which types of business and clients should use overnight SONIA, relative to alternatives including forward-looking term rates.

The Loan Market Association (LMA) has also drafted new template loan agreements to accommodate SONIA compounded in arrears. The LMA have also published an exposure draft to cover multicurrency term and revolving facilities agreement incorporating rate switch provisions ("Rate Switch Agreement").

18. What timetables and targets are in place for the transition to SONIA?

Lenders are working on the targets set by the Sterling RFRWG to make SONIA-based loans products available by the end of Q3 2020. It is expected that some borrowers may be ready to make use of these alternative products. The working group acknowledges LIBOR-referencing loan products will continue to be used in Q4 2020 to maintain the smooth flow of credit to the economy.

Taking this into consideration the Sterling RFRWG recommends that:

1. By the end of **Q3 2020**:
   - Lenders should be in a position to offer non-LIBOR linked products;
   - Lenders working with their borrowers should include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion ahead of end-2021, through pre-agreed conversion terms or an agreed process for renegotiation, to SONIA or other alternatives.*

2. By the end of **Q1 2021**:
    - All new issuance of GBP LIBOR-referencing loan products that expire after the end of 2021 should cease;
    - Lender and borrowers accelerate active conversion of cash products where viable to reduce the legacy volume.
3. By the end of **Q2/Q3 2021**:
    - Lenders and borrowers complete active conversion of cash products. Where active conversion is not possible for loans, ensure robust fallbacks are adopted.

In July 2020, the Sterling RFRWG released an updated UK RFR Roadmap including a table providing a product-by-product view of the steps needed to meet the key milestones established by the Working Group.

**Note that there is now a revised version of the* Loan Market Association *(LMA) Screen Rate Replacement language designed to support these requirements.*

19. Are some GBP LIBOR dependent products already transitioning to SONIA?

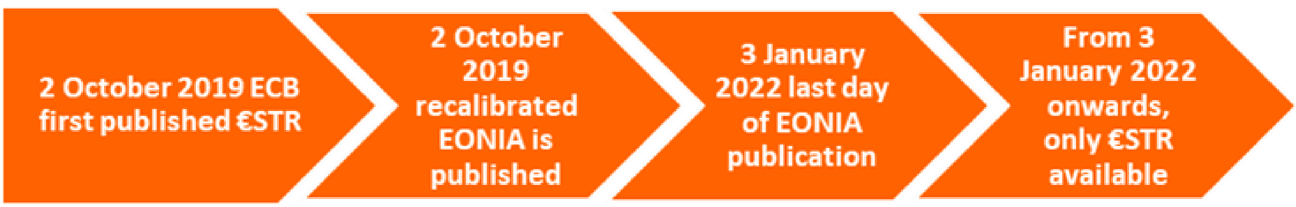
There has been some good progress in establishing SONIA as the successor to GBP LIBOR. A number of positive developments took place in the markets, including:

- SONIA-linked FRN issuance now dominates sterling floating rate financials issuance and there is clear momentum towards using the compounded SONIA rate across bond markets more generally;
- Use of compounded SONIA has become established as the market standard for sterling securitisations;
- A number of consent solicitation have taken place to convert legacy transactions to a SONIA-based reference.

Other topics

20. What changes are happening to the euro overnight index average (EONIA)??

As a result of insufficient transaction volumes preventing EONIA from becoming BMR compliant, the European Money Markets Institute (EMMI) announced that EONIA will no longer be published as of 3 January 2022.



The Euro Risk Free Rate Working Group has recommended the Euro Short-Term Rate (€STR) as the alternative rate and the eventual replacement rate of EONIA. €STR measures the wholesale euro unsecured overnight borrowing cost for banks in the euro area based on transaction data collected by the Euro-system for money market statistical (MMSR) purposes. €STR is administered by the ECB and was first published on 2 October 2019.

To bridge the period of transition, EONIA is determined and published on the basis of €STR + 8.5 basis points (0.085%). The ECB calculated this spread based on daily EONIA and pre-€STR data from mid-April 2018 to mid-April 2019. This approach is designed to ensure that EONIA's economic value is not modified by the new calculation methodology. Between 2 October 2019 and 3 January 2022 both benchmarks will co-exist to facilitate a smooth transition from EONIA to €STR. During this period, the market (and ING) will increasingly offer products based on €STR.

For further details, please refer to the Working Group on Euro Risk-Free Rates' FAQ and checklist on the transition from EONIA to €STR.

21. Are central counterparty clearing houses (CCP) amending the discount curves for derivatives?

LCH, Eurex and CME completed the task of replacing EONIA with €STR as discount rate for cleared euro derivatives **on 27 July 2020.** As this discounting change (a shift of 8.5 basis points) led to a valuation impact, a one-off cash compensation payment has been made between the CCPs and their clearing members to compensate for any value transfer.

On 16 October 2020, CME and LCH are scheduled to switch from using the effective federal funds rate (EFFR) to using SOFR. The discount curve will change to SOFR for cleared USD derivatives and will also apply to the calculation of interest due on collateral posted, known as Price Alignment Interest (PAI). These clearing houses will apply a combination of cash compensation for the economic impact as well as a number of standardised fed fund–SOFR basis swaps to account for the change in risk profile. Unlike for the euro, where €STR is a replacement for EONIA, the fed funds rate will not disappear for the foreseeable future.

Counterparties that enter into bilateral (non-cleared) derivative transactions and have a Credit Support Annex (CSA) to mitigate credit risks are also affected by benchmark changes. It is the intention of the market to transition bilateral CSA agreements in a similar manner over the coming months.

ING has started the bilateral CSA repapering process (commencing with the legal entity ING Bank NV) and will enter into discussions with counterparties about any required amendments to CSA agreements and any valuation adjustments. Once agreed, an effective date will be determined for the discount curve change and any valuation adjustment amount will be agreed and compensated.

22. What is the latest on EURIBOR?

EURIBOR Panel banks progressively transitioned to a new submission methodology in 2019. EURIBOR is now BMR compliant and can therefore continue to be used in new and legacy contracts. In September 2020, ESMA (who will substitute the Belgian FSMA as supervisor of EURIBOR in January 2022) has indicated that the discontinuation of EURIBOR is not part of their plans and reinforced the importance of introducing effective fallbacks in EURIBOR contracts to ensure their continuity in the unlikely scenario of discontinuation of EURIBOR.

In light of these developments, the Working Group on Euro Risk-Free Rates is continuing its work on €STR-based fallbacks. Both backward and forward-looking rates are being considered as options. Two public consultations are expected in Q4 2020. The first will cover the preferred EURIBOR fallback rate for each financial product and the preferred spread adjustment to avoid potential value transfers upon activation of the fallback.

The second public consultation will cover a set of trigger events for the application of the respective fallback rates. The Working Group aims to have the final recommendations published in Q1 2021.

For further details, please refer to the Working Group on Euro Risk-Free Rates website.

23. What reliefs are being considered by other regulatory authorities?

Numerous regulatory bodies, such as those that govern accounting and taxation, appreciate the challenges this transition brings to the banking and corporate sector. As such, a number of actions have been taken, either in the form of clarification or target reliefs. Some key examples include:

1. The International Accounting Standards Board has issued the following Interest Rate Benchmark Reform amendments:
   - changes to contractual cash flows — a company will not have to derecognise or adjust the carrying amount of financial instruments for changes required by the reform, but will instead update the effective interest rate to reflect the change to the alternative benchmark rate;
   - hedge accounting — a company will not have to discontinue its hedge accounting solely because it makes changes required by the reform, if the hedge meets other hedge accounting criteria.

In the US, the Financial Accounting Standards Board (FASB) had already provided a similar update (ASU 2020-04) earlier this year.

2. Market regulators have issued relief to reduce certain requirements that a benchmark transition event could trigger. For example:
   - The Commodity Futures and Trading Commission (CFTC) announced relief, subject to various terms and conditions, for swap dealers (SD) and other market participants related to the industry-wide transition from swaps that reference alternative benchmarks. The relief is expected to help smooth the transition away from IBORs by removing regulatory obstacles, which if not done, would otherwise had triggered numerous CFTC requirements that were not intended to apply in such situation.

24. Is COVID-19 impacting the transition timetable?

The FCA, the Bank of England and members of the Sterling RFRWG have discussed the impact of the coronavirus on the transition. To offer some relief, a number of interim target dates have been deferred by several months. However, they have stated that the transition away from LIBOR remains an essential task that will strengthen the global financial system. Hence, the assumption that market participants cannot rely on LIBOR being published after the end of 2021, remains.

Alongside other international authorities, the FCA and relevant working groups will continue to monitor and assess the impact on transition timelines and will update the market accordingly.

For further details, please refer to the Sterling RFRWG's statement on the impact of coronavirus on the LIBOR transition timeline.

25. What can our clients do to prepare for the transition?

While uncertainties remain, as part of the transition, we encourage our clients to perform an assessment of their LIBOR-referenced exposures and stay up to date with ongoing developments. We recommend that our clients familiarise themselves with the RFRs and consider transacting in RFR-referenced products. Clients may want to engage independent consultants for advice, particularly when reviewing the contractual terms governing their exposures that mature after 2021 and assessing the robustness of the current fallback language. From an accounting, tax and regulatory perspective, you may also want to consider the potential impacts the LIBOR discontinuation may have on your businesses' treasury and risk management systems and processes.

ING is working on product development and transition, and will continue that effort throughout 2021. For impacted contracts and products, ING will reach-out to you and discuss the options for the transition.

If you have any questions about IBOR transition that are not answered here, please contact your relationship manager at ING.