Bank of Baroda (UK) Limited

Libor Transition - What you need to know

LIBOR Transition

As you might have read over the past few months and also through communication with the bank in 2020, LIBOR as a benchmark for setting interest rates is due to end on 31 December 2021. If you currently have a Libor related loan facility with us which matures after 31 December 2021, then it is likely that your facility will need to be transitioned to an alternate reference rate (ARR).

The following sections are intended to provide you with an overview of the Libor transition timetable and the alternatives available to you as advised by the various regulatory authorities.

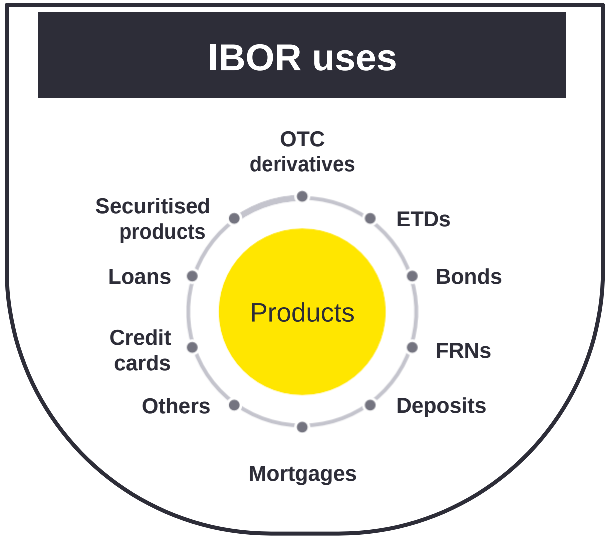
We will be in touch with the impacted customers individually to discuss next steps with them.

What is happening to LIBOR?

- In 2017 the Chief Executive of the UK's Financial Conduct Authority (FCA), announced that market participants should not rely on LIBOR being available after 2021 and that firms should prepare to transition away from LIBOR. From the end of December 2021, panel banks will no longer be compelled to submit to LIBOR in the UK. The Bank of England (BoE) is facilitating a Working Group on Sterling Risk-Free Reference Rates (RFR WG) to identify alternative benchmark rates for LIBOR.
- In the US the Federal Reserve Board and the Federal Reserve Bank (NY FED) has facilitated the Alternative Reference Rates Committee (ARRC) to identify the preferred alternative to USD LIBOR.
- The Intercontinental Exchange Benchmark Administration has announced its intention to cease publication of 1m and 2m USD LIBOR by the end of December 2021, with all other USD LIBOR benchmarks being published up until the 30th June 2023.
- Regulators across further jurisdictions, such as the European Union, Japan & Switzerland have declared that IBOR (inter-bank offered exchange rate) will cease to exist for both legacy and new contracts, across derivative and cash markets, by the end of 2021. In September 2018, the ECB's working group on euro risk-free rates recommended €STR as the new risk-free rate and replacement rate for EONIA, which is to be discontinued on the 3rd January 2022. The Swiss Financial Market Supervisory Authority and Bank of Japan have an expectation that market participants undertake all necessary steps to ensure LIBOR is replaced by the end of December 2021.

LIBOR market footprint:

USD LIBOR and EURIBOR	Derivatives	Syndicated loans	FRNs	Business loans	Tenor
USD LIBOR and Euribor together represent approximately 80% of the total IBOR market exposure	OTC and ETDs represent more than $300tn (80%) of products referencing IBORs	$1.5tn of syndicated loans in the U.S. market reference USD LIBOR. 90% of the $535bn of syndicated loans in the European market reference Euribor	US$1.8tn of FRNs in the U.S. market reference USD LIBOR. 70% of the $2.6tn of FRNs in the euro market reference Euribor	$0.8tn of bilateral business loans in the U.S. market reference USD LIBOR. 60% of the $4.3tn of bilateral business loans in the euro market reference Euribor	The 3-month tenor by volume is the most widely referenced across the majority of currencies, including USD, followed by 6-month and 1-month



What is happening to LIBOR: Useful information on the major Alternative Reference Rates (1)

Working groups in each jurisdiction have recommended robust, alternative RFRs to transition away from existing IBORs. The RFR benchmarks are transaction based, overnight rates, whereas current use of IBORs is largely in term rates.

Jurisdiction			
IBORs	GBP LIBOR	USD LIBOR	EURIBOR, Euro LIBOR
Working Group	Working group on sterling risk-free reference rates	Alternative reference rates committee	Working group on euro risk-free rates
Alternative RFR	Reformed sterling overnight index average (SONIA)	Secured overnight financing rate (SOFR)	Euro short-term rate (ESTER)
Rate administrator	Bank of England	Federal Reserve Bank of New York	European Central Bank
Description	➢ Unsecured ➢ Fully transaction-based ➢ Overnight, nearly risk-free reference rate ➢ Includes a volume-weighted trimmed mean ➢ Published by the Bank of England since April 2018	➢ Secured ➢ Fully transaction-based ➢ Overnight, nearly risk-free reference rate that correlates closely with other money market rates ➢ Covers multiple repo market segments, allowing for future market evolution ➢ Published since April 2018	➢ Unsecured ➢ In Sep 2018 ECB has announced that ESTER is chosen as ARR. Launched Oct 2019 ➢ Reflects the wholesale borrowing costs of euro area banks ➢ Published since October 2019
Deadlines & Transition Milestones	➢ Q3 2020: Lenders to include contractual arrangements in new and re-financed LIBOR-referencing loan products to facilitate conversion to SONIA or other alternatives ➢ Q4 2020: Interest rate swap conventions: Sterling swaps liquidity providers to adopt new quoting conventions based on SONIA on 27 October 2020 ➢ Q1 2021: Cease initiation of new Sterling LIBOR linked linear derivatives and cash products maturing after 2021 ➢ Q2/Q3 2021: Cease new issuance of Sterling LIBOR linked non-linear and cross currency derivatives that mature after 2021	➢ Q3 2020: New syndicated business loans, bilateral business loans and student loans should include ARRC recommended hardwired fallback language ➢ Q4 2020: Dealers amend interdealer CSAs (credit support annexes) to use and make markets in SOFR-linked interest rate volatility products ➢ Q2 2021: No new LIBOR business loans, floating-rate securitizations (with the exception of CLOs) , or derivative trades that increase LIBOR risk	➢ Q4 2021: EONIA to be discontinued

Alternative Reference Rates (2)

Jurisdiction		
IBORs	GBP LIBOR	USD LIBOR
Working Group	Working group on sterling risk-free reference rates	Alternative reference rates committee
Alternative Reference Rate	Bank of England Base Rate (Bank Rate)	Federal Funds Rate (Fed Funds)
Rate administrator	BofE Monetary Policy Committee	Federal Open Market Committee
Website	https://www.bankofengland.co.uk/monetary-policy/the-interest-rate-bank-rate	https://apps.newyorkfed.org/markets/autorates/fed%20funds
Description	➢ The interest rate that the Bank of England charges Banks for secured overnight lending. It is the British Government's key interest rate for enacting monetary policy. ➢ Changes are recommended by the Monetary Policy Committee and enacted by the Bank's Governor ➢ Not transaction-based ➢ Published by the Bank of England since 1694	➢ The interest rate at which banks and credit unions lend reserve balances to other depository institutions overnight on an uncollateralised basis. ➢ Reserve balances are amounts held at the Federal Reserve to maintain depository institutions' reserve requirements. ➢ Not transaction-based ➢ Published by the Federal Open Market Committee since 1979
Deadlines & Transition Milestones	➢ Q1 2021: Cease initiation of new Sterling LIBOR linked linear derivatives and cash products maturing after 2021 ➢ Q2/Q3 2021: Cease new issuance of Sterling LIBOR linked non-linear and cross currency derivatives that mature after 2021	➢ Q2 2021: No new LIBOR business loans, floating-rate securitizations (with the exception of CLOs) , or derivative trades that increase LIBOR risk ➢ On 30th November'20, the ICE Benchmark Administration announced that it will consult in early December on its intention to cease USD Libor. The IBA intends that subject to confirmation following its consultation, 1 week and 2 month USD Libor settings will cease at end-2021, and that the USD Libor 3 and 6 month panel will cease at end-June 2023.

Further Information Table – A list of regulators & relevant trade bodies

The transition away from LIBOR is taking place on a global scale and Alternative Risk Free Rates (RFRs) have been selected for all 5 LIBOR currencies . Below we have listed the relevant regulatory bodies for in the UK, USA, Europe and international bodies

- United Kingdom - Bank of England RFR Working Group
  FCA LIBOR Transition Page
  Bank of England Governor Speech - Entering the Endgame
  HMRC Guidance on tax implications
- United States - Alternative Reference Rates Committee Website
  ARRC Best Practices for LIBOR Transition
  ARRC Transition Aid
- European Union - ECB Working Group
- ICE Benchmark Administration - IBA IBOR Transition
- International Swaps & Derivatives Association - ISDA IBOR Transition
- Loan Market Association -Loan Market Association - The future of LIBOR

Next Steps

- Fallbacks: We will reach out to all clients regarding updates to the fallback clauses in their documentation – this process will be managed by our credit and internal legal teams.
- Independent Advice: Clients should consider taking independent advice on the LIBOR transition and the impact it could have on their firm, in particular in the areas of accounting, legal and taxation.
- Transition Options & Timings: We will contact all of our clients by June 2021 with transition methodology and options for the transition of their LIBOR impacted facilities.
- What do you need to do next?
  i. Review your current systems to enable the transition to a new ARR when required. To ensure that your firm can manage the transition effectively, keep up to date with the various regulators and developments around the globe regarding the transition from LIBOR to RFRs
  ii. Consider your internal exposures
  iii. We have recently sent out a letter to impacted customers. We will contact you again by June 2021 with transition methodology and options for your LIBOR impacted facilities
  iv. We will also reach out to you to regarding the updates to the fallback clauses in your documentation – this will be managed by our credit and internal legal teams

FAQs

➢ Why are we transitioning away from LIBOR?

The submission of LIBOR by panel banks is being discontinued as the number of transactions in the underlying market, for unsecured wholesale term lending to panel banks, has fallen significantly. This declining liquidity has made LIBOR vulnerable to manipulation and increased the probability of the rate being unrepresentative of unsecure funding costs. Bank of England Governor Andrew Bailey noted in a recent speech that ‘Libor is trying to measure a market – the market for unsecured wholesale term lending to banks – that is no longer sufficiently active. The low levels of underlying activity make it fragile and more susceptible to liquidity and amplification effects in financial markets.

➢ What Alternate Reference Rates have been recommended by industry bodies for each currency?

Currency	ARR	Description
GBP	SONIA	Unsecured, fully transaction-based, overnight, nearly risk-free reference rate which includes a volume-weighted trimmed mean
USD	SOFR	Secure fully transaction-based, overnight, nearly risk-free reference rate that correlates closely with other money market rates Covers multiple repo market segments, allowing for future market evolution
Euro	€STR	Unsecured, reflects the wholesale borrowing costs of euro area banks

➢ What is different about the Alternative Reference Rates compared to LIBORs?

i. RFRs are point in time overnight rates, whereas IBOR rates are forward-looking for certain identified terms (1 month, 3 month etc.)

ii. LIBOR prices in term risk and bank credit risk whereas the Alternative RFRs do not

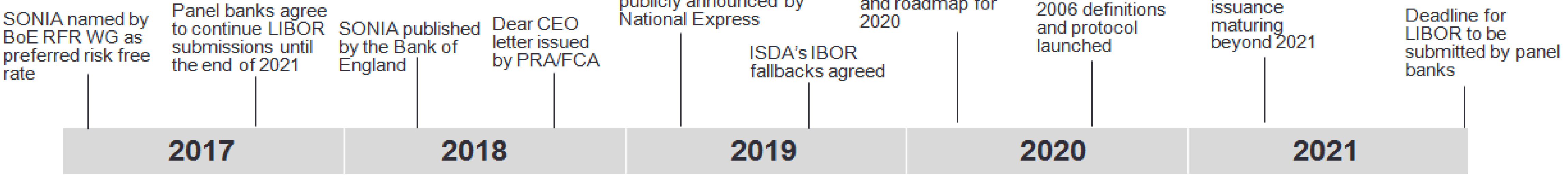
iii. RFR interest is payable over a period is typically calculated by daily compounding a series of overnight rates with the interest due being calculated at the end of the relevant interest period, rather than at the beginning. As term risk and bank credit risk are not included in RFRs, an adjustment spread may be added to the compounded RFR. This is known as a Credit Adjustment Spread

➢ When is the deadline for the cessation of LIBOR?

i. The FCA has set a deadline of Q1 2021 is the deadline for the cessation of issuance of GBP LIBOR loans maturing after 2021

ii. In the US a deadline of Q2 2021 has been set for the end of new LIBOR business loans, floating-rate and derivative trades

How is the LIBOR transition proceeding?



➢ What is a fallback provision?

A fallback provision is a clause setting out the alternative rate to be used when the benchmark referred to in the contract is no longer viable.

➢ How do fallbacks apply for loans and derivatives contracts?

For derivatives, The International Swaps & Derivatives Association, IBOR Fallbacks Supplement and IBOR Fallbacks Protocol which incorporates robust fallbacks for derivatives linked to certain IBORs, with the changes coming into effect on January 25, 2021

For loans, The Loan Market Association (LMA) has led efforts to produce fallback language for loan products. Legal documentation for loans is more diverse than for derivatives, and the fallbacks are more complex and open to potential value transfer.

➢ What do you need to do next?

i. Review your current systems to enable the transition to a new ARR when required. To ensure that your firm can manage the transition effectively, keep up to date with the various regulators and developments around the globe regarding the transition from LIBOR to RFRs

ii. Consider your internal exposures

iii. We have recently sent out a letter identifying your LIBOR exposures. We will contact you again by June 2021 with transition methodology and options for your LIBOR impacted facilities

iv. We will also reach out to you to regarding the updates to the fallback clauses in your documentation – this will be managed by our credit and internal legal teams