

NAVIGATING THE LIBOR TRANSITION

A practical guide for financial professionals looking to
assess the current market and find alternatives to LIBOR

An LSEG Business

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INTRODUCTION

LIBOR is coming to an end on 31 December 2021 and businesses of every scale will need to adapt to a new market landscape. It will be a challenge, but at Refinitiv we can make that transition seamless.

We have created this e-book to help organisations prepare for the imminent post-LIBOR world. It explains LIBOR and the new benchmark rates set to replace it in the financial markets, shares the key challenges facing organisations, and sets out how we can help you manage the migration smoothly and successfully.



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What is LIBOR – and why is it coming to an end?

he most important number used by the financial markets used to be calculated every weekday by two people working in the office of the British Bankers' Association (BBA) in the London Docklands. This daily routine was so important to the normal functioning of the financial system that contingency plans were in place should a terrorist attack or any other incident prevent these two co-ordinators from reaching the BBA office. Just after 11am, they would receive submissions from traders at leading banks around the world that estimated how much it would cost to borrow from other banks, without putting up collateral. These estimates would be collected, the figures on the lowest and highest quartile discarded, and the average of the remainder computed. The result was the London Interbank Offered Rate, or LIBOR for short. This calculation would be repeated for many different

currencies and seven loan maturities, ranging from overnight to one year.

Since LIBOR first became widespread across the global markets, it has represented how much it costs banks to get the money in the form of mortgages and business loans. If a company wants to borrow money, usually the interest rate will be LIBOR plus a fixed spread – the spread in this case representing the bank's profit. Later, the rate became even more important in the fast expanding interest-rate derivatives market, where traders started tying the benchmark rate to financial products such as swap transactions and future contracts.

However, as markets evolved, the trading volume of interbank loans that used to inform the estimates for LIBOR dried up. The estimates submitted by traders increasingly became more hypothetical than real and more prone to manipulation. And that's

precisely what happened. Between 2005 and 2007, traders at Barclays regularly submitted biased estimate rates based on their own derivative trading positions, to boost their profits. Later, during the financial crisis of 2008, Barclays executives forced employees to submit artificially low estimates to the BBA, to create the false impression that the bank could borrow more cheaply from other banks than it could. After a series of criminal investigations into LIBOR abuse, more than a dozen banks were implicated in the scandal, resulting in more than \$9 billion in legal fines.

Above: LIBOR's influence crosses currencies and global markets



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In July 2014, regulators at the Financial Stability Board pressed market participants and central banks to put forward alternative benchmarks that could replace LIBOR.

Countries around the world established working groups to study potential new rates, and a raft of new benchmark rates were introduced. In the U.S., officials introduced the secured overnight funding rate (SOFR); the UK opted for the sterling overnight index average (SONIA); and the Eurozone introduced the euro short-term rate (€STR).

Unlike LIBOR, these new rates are administered by central banks and calculated from actual market transactions, making them inherently more robust against manipulation. SOFR, for instance, is based on collateralised overnight transactions in the so-called repurchase agreements (or repo) markets, on which around \$660 billion are traded daily. SONIA, on the other hand,

The benchmark rate may no longer exist in its current form by the end of 2021

represented a £30 trillion market of daily trades on unsecured overnight funds (this UK rate in fact was not a new rate, but had been established since 1997, and was reformed in 2018 by the Bank of England).

In late 2017, the UK's Financial Conduct Authority announced that it would no longer require panel banks to submit LIBOR estimates after 31 December 2021, which meant that the benchmark rate may no longer exist in its current form by the end of 2021, which cannot be ignored.

What are alternatives to LIBOR – and why are they better?

Above: alternative benchmark rates may be less prone to manipulation

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he 31 December 2021 deadline and the phasing out of LIBOR has put pressure on companies and banks not only to stop writing new financial contracts that are tied to LIBOR, but also to rewrite current ones in order to replace the rate with the more robust alternatives in the various markets.

This is far from an easy task. “People don’t appreciate just what a big change is coming,” says Jacob Rank-Broadley, the head of LIBOR transition at Refinitiv. “I think conceptually it seems straightforward to say that there’s a benchmark that’s going to end and we’re going to replace it with something else. But that’s an extremely optimistic way of thinking about it.” The problem, he says, is that for more than 30 years LIBOR has become deeply embedded in the workflows, IT systems and financial contracts in banks and businesses everywhere – the “plumbing of the global financial system”. “There’s no documentation of where it is embedded, so it’s very difficult to even know what the starting point for this migration is,” he says.

Overall, it is estimated that more than \$370 trillion in financial contracts are

pegged to LIBOR, notionally more than four times global gross domestic product. Replacing these contracts alone is such a gargantuan, complex legal undertaking that some have referred to it as being “a bigger problem than Brexit”. It is certainly one that cannot be ignored or delayed.

In the meantime, LIBOR continues to be calculated every day, now by the Intercontinental Exchange Benchmark Administration (IBA – which replaced the BBA in 2013). The new administrators operate under a new code of ethical conduct and use a more

It is estimated that more than \$370 trillion in financial contracts are pegged to LIBOR

What does this mean for businesses?



robust calculation methodology, although the basic principles remain the same. At around 11:55am, Refinitiv publishes and communicates the number to thousands of traders around the world. It remains the single most-watched number in the financial system: if it suddenly disappeared before its deadline, the global financial system would still grind to a halt. “The main challenge is that many people are still not familiar with the migration,” Rank-Broadley says. “I think the sooner you learn about the migration and how that is going to take place for your business, then you can avoid potentially ending up in a pretty unpalatable situation at the end of the year.”

Several sectors stand to be heavily impacted by the impending LIBOR transition. We have created this e-book to help organisations prepare for the imminent post-LIBOR world. It explains LIBOR and the new benchmark rates set to replace it in the financial markets, shares the key challenges facing organisations, and sets out how Refinitiv’s software and analytics tools can help them manage the migration smoothly and successfully.

Left: a post-LIBOR world is close, and businesses must prepare

INVESTING IN THE TRANSITION

Major banks will spend more than \$100 million preparing for the transition away from LIBOR in 2021, according to an estimate by professional services firm Ernst & Young. This budget will go towards overhauling IT systems, settling payments, renegotiating existing contracts and repapering new ones.

Dedicated teams have been set up to deal with the migration to new benchmark rates, co-ordinating across different teams and functions inside major firms. So, how can organisations take the necessary steps to be ready for the transition?



Start with the right information

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or many of our customers at Refinitiv, the starting point for the transition is Refinitiv Eikon, a desktop-based open platform that provides a range of real-time data feeds, tools and analytics for all markets, and has a global presence – it’s used by more than 70,000 traders around the world. “We know that customers are going to need a lot

of different data sets and tools to support them with the transition,” says David Bull, Refinitiv’s director of Data Management and Strategy. To address this need, last year, we added a dedicated app to the Eikon terminal called IBOR. This acts as a central hub to help customers with the first three steps in managing the transition: educating themselves, building understanding of exposure and finding alternatives.

The app has links to central bank working groups as well as the International Securities and Derivatives Association (ISDA), the global trade organisation for the derivatives market. The app not only includes links to daily Reuters news coverage but a series of screens providing real-time information on the new benchmark rates such as SONIA, €STR, SOFR, TONA, CORRA, SARON and SORA, along with associated market

data and analytics. “We are able to capture new cash and derivative products that come to market based on the new benchmarks and know where the liquidity and the pricing is actually happening,” Bull says. “The Eikon landing page gathers all the information that is related to the transition into a single page, which makes it easy for customers to get that perspective.”

Above: having the facts at your fingertips is the key to success



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Build understanding of LIBOR and your potential exposure

While global, regional and domestic banks are dedicating the necessary resources to the LIBOR migration, for the majority of smaller institutions that will also be affected by it – corporates or small businesses – this process is either only just beginning or has yet to start. “These are customers who just don’t spend time focusing on issues like this because they’ve got lots of other things to worry about,” says Rank-Broadley. Among that list of urgent priorities are issues like Covid-19 and Brexit. “In some cases, many of the people responsible will not even be aware that LIBOR is vanishing.” Alexandre Hardouin, Refinitiv’s Head of Rates, agrees on the need for outreach and education. “We have customer success managers deployed globally to help and actively engage with all sorts of customers and

educate them because, understandably, it’s not part of their day-to-day job,” he says. “Very often these meetings start with simple questions: please tell me what’s going on, what are the timelines, what are the actions we need to take, what are the new rates, how do I manage the transition?”

The next step for businesses is to work out their exposure to LIBOR. This implies sifting through masses of financial contracts, many still in paper format, to find where the benchmark rate is referenced and then to identify the processes, applications and workflows inside the company that are using LIBOR data. “You need that understanding of what products and systems currently use LIBOR,” Bull says. “This is a challenge because LIBOR has been so embedded in applications and processes in big institutions for 30 years, so the challenge is to build out that inventory so they can then figure out how they are going to replace it with an alternative number. Institutions need to be acting now – they can’t afford to delay.”

Implement alternatives

While looking for exposure, businesses should review legal documentation to identify “fallbacks” within existing contracts. These fallbacks are effectively legal rules that spell out what happens if LIBOR ceased to exist. Fallbacks mean that both parties in the contracts don’t need to renegotiate the alternative reference rate in a post-LIBOR world. All they need to do is to follow the fallback rules that were previously agreed as part of the contract.

Above: all sizes of institution will need to address their LIBOR data

CHALLENGES AND SOLUTIONS

Although the transition away from LIBOR brings with it a number of complexities, we have developed a suite of smart solutions to help Refinitiv customers seamlessly navigate the challenges ahead.



Reviewing documentation doesn't have to be a time-consuming process

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aced with constraints on time, businesses can feel overwhelmed by the prospect of wading through old contracts.

In addition to the need to assess LIBOR exposure by reviewing vast quantities of paperwork, professionals must review documentation to identify fallback clauses. Regardless of industry or sector, fallbacks can impact any business and will be one of the biggest challenges businesses

will face as they look towards transition.

Traditionally, reviewing vast quantities of historic documentation was a time-consuming task because fallback provisions are usually written in the sort of fluid legal language that is difficult to capture in a standardised way. At Refinitiv we understand that for many of our customers, especially smaller institutions, this is an incredibly difficult and labour-intensive stage – and we have a time-saving solution. “We’ve added specific LIBOR fallback data fields and identifiers to our databases, so customers can just submit a list of their financial products and, in return, you get information on whether that product references LIBOR and what the fallback language is,” Hardouin says. Already available as part of Refinitiv’s DataScope products, it provides organisations with a lot of information in a user-friendly format to help them rapidly identify their inventory.

Above: tools to assist reviewing old contracts will prove invaluable



A new global protocol means smoother contract updates for the derivatives market

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On 25 January 2021, the ISDA introduced a new protocol that promises to make the benchmark rate migration a lot smoother in the derivatives market – the biggest market for LIBOR. The new protocol – which has been dubbed ISDA IBOR Benchmark Fallback rates – can automatically remove references

to LIBOR and incorporate standardised fallback language into existing derivatives contracts. This will allow an update in the fallback language applied to millions of existing trades, and guarantee appropriate provisions in new ones. Nearly 12,000 financial institutions – including banks such as Barclays and JP Morgan Chase & Co. – have already adopted this protocol. As an authorised distributor, we have integrated the ISDA IBOR Benchmark Fallback rates into products including Refinitiv Datascope, ensuring seamless and automated transitions for customers operating in this market.

However, cash products such as loans and bonds are not covered by the ISDA protocol. According to estimates, there are over \$12 trillion in long-term loans that will need to be converted because they mature after 2021, and the majority of these

Above: use of new protocols can be done automatically

contracts don't contemplate a scenario where LIBOR ceases to exist. However, in March 2021, the Alternative Rates Reference Committee (ARRC) issued recommended fallback language that specifies the alternative rate to be used in such circumstances. ARRC exclusively chose Refinitiv as the official publisher of its cash products fallback rates. According to ARRC chairman, Tom Wipf, choosing Refinitiv as a preferred vendor ensures that their cash product rates "can be effectively accessed and implemented by all relevant market participants."



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Offering timely guidance in a complex market

aking new contracts using the new, alternative benchmark rates, such as SOFR and SONIA, is also not a trivial problem, particularly because these rates are fundamentally different from LIBOR.

LIBOR is a forward-looking rate that measures a bank's market expectations over the cost of borrowing over a particular duration: one month, six months, one year, and so on. This so-called term structure provides borrowers with much-needed predictability when it comes to managing the cash flow of their businesses. In contrast, the new benchmark rates track backward-looking lending overnight: SOFR is based on collated overnight transactions in the repo market, while SONIA measures the rate paid on unsecured overnight funds. "LIBOR has a term structure, which means today's market participants know the cost of borrowing for a certain period in future. LIBOR also measures the interbank rate,

meaning that there is an element of credit risk captured within the benchmark," says Rank-Broadley. "The default recommended replacements for LIBOR have neither of those. So, the question becomes, how do I then fit that new benchmark into all these existing contracts which could still be around for five, ten, twenty years? That's where the complexity comes from."

"We designed and tested a new SONIA term rate over the course of early 2020," says Rank-Broadley. During this period, because of Covid-19 and Brexit, the markets were extremely volatile. "That was really good in terms of giving us an understanding of how the benchmark would perform during uncertain times, allowing us to refine and calibrate the methodology until we got to the point we were confident that it was suitable and fit for purpose."

In July 2020, Refinitiv launched the new SONIA term reference rate as a prototype,

publishing it on a regular basis on their website. "We did that in order to collect feedback and to try to get our customers familiar and comfortable with this rate, to see how it behaved," says Rank-Broadley. It was important for customers to realise that this alternative is not meant to replicate LIBOR, he says. "It's not got that credit spread and it doesn't behave the same way. If you plot our benchmark versus if you plot LIBOR, that credit spread element does change significantly over time."

After further refinements during that phase, Refinitiv Term SONIA finally went

Above: changed rates made a complex market even trickier



live on 11 January 2021, available in tenors of one, three, six months and one year, and published on business days at 11:50am London time. It's now administered by a regulated entity called RBSL which is a fully owned subsidiary of Refinitiv, and subject to oversight from the FCA. "It's early days, but we're very pleased as the rate has been accessed over 100,000 times from our terminal from over 600 customers." Rank-Broadley says. "Our expectation is that we'll see more and more systematic use during the remainder of the year."

The Refinitiv Term SONIA might also be useful in a more complex scenario where the market starts using a "synthetic" LIBOR for a certain period of time as they undergo transition. Currently, the FCA is in consultation with various market participants on whether they will require the IBA to continue publishing the one-month, three-month and six-month sterling LIBOR

rates using a different calculation method, dubbed "synthetic". These "synthetic" LIBOR rates are used in the case of legacy contracts that reference LIBOR but don't provide a way of converting them into an alternative benchmark rate to reduce disruption in the market (new contracts, on the other hand, would not be allowed to use the "synthetic" rate). In the case of sterling LIBOR, it's likely that this new methodology would simply be a term SONIA plus a fixed credit spread adjustment. In other cases, such as with Japanese yen, LIBOR and LIBOR US, the "synthetic" LIBOR protects market integrity by enabling more time to transition.

The challenge now – and one that we can guide customers through – is education and addressing the concerns of borrowers, as well as equipping them with the data they need to secure better outcomes for their organisation. Many of these borrowers

Above: data is a critical aid for decision making

are not necessarily treasury specialists, but will rather be finance directors or CEOs who might be cautious about, or perhaps unaware of, a brand-new benchmark.

To support these borrowers adequately, our Refinitiv teams run customer briefing sessions to explain the new SONIA term rate, how it was built, and the possible benefits to be reaped by incorporating a new term structure. This vital combination of knowledge and data supports their decision making and informs their conversations with the institution issuing them the loan or the trade finance product.

MAPPING THE PATH AHEAD

Waiting until the transition deadline passes isn't an option – businesses need to prepare now to address the challenges created by the end of LIBOR and the adoption of alternative benchmark rates.



On Friday 5 March 2021, the FCA issued a statement confirming what most knew was coming: sterling, euro, the Swiss franc and Japanese yen settings, and the one-week and two-month U.S. dollar settings will cease immediately after 31 December 2021. The Alternative Reference Rates Committee (ARRC) issued an accompanying statement, announcing that the U.S. market would have until after 30 June 2023 to manage the transition. As such, except for the U.S., LIBOR will stop by the end of the year. This effectively means one thing: the time to take action is here and now.

So far, however, the global adoption of the alternative benchmark rates has been slow. As of March 2021 in the U.S. derivatives market, only 1.28% overnight indexed swaps and basis swaps in notional value are pegged to SOFR, while in Europe, €STR is only referenced in 0.40% of new derivative contracts. The LIBOR transition in the UK market, on the other hand, has been far smoother, with active trading of new derivatives pegged to SONIA at more than 57%. This reflects the fact that SONIA was already an established measure, with a 23-year history in the markets with a significant volume of transactions. "One of the reasons that the UK seems to be ahead is that the manipulation of LIBOR happened in London, and the Bank of England and Financial Conduct Authority took the lead early on to get rid of it," says Hardouin. "They decided to go with SONIA, which is well established and already used, as the market participants know how it works, and there was already plenty of liquidity."

The migration was also complicated by Covid-19, which disrupted financial markets and threw business markets into high levels of volatility and uncertainty. Given the urgent requests for help to keep companies afloat, both the U.S. and the UK governments launched emergency loan programmes pegged to LIBOR.

Businesses, however, can't afford to wait until the LIBOR transition deadline. Those investing on behalf of their customers



Begin preparing for change now

have a clear obligation to ensure that they are selling financial products that are fit for purpose and tagged to alternative benchmark rates. Selling investments against LIBOR knowing that the rate will cease to exist in a few months' time is neglecting the best interest of customers, and risks losing out on where the markets and liquidity will move to in the near future.

This migration constitutes the biggest shift in the industry in the past decade. Although it's no doubt disruptive, it is also a positive change, representing a future for the financial markets that will be transparent, data-driven and innovative.

We have an incredibly strong track record of doing everything possible to help prepare customers for this transition across all markets. After the early success of the Refinitiv Term Sonia reference rate, we have already submitted a proposal for a forward-looking term SOFR rate to the ARRC and is planning on launching a forward-looking term €STR rate. Even though those markets still register low liquidity, launching early prototypes of term rates will allow us to conduct testing, receive feedback, iterate and, eventually, be able to offer customers robust term

rates as soon as the markets are ready.

Being ready for this transition is critical – and while some organisations have rightly started preparing for it, many others are still grappling with some key questions: what are the new benchmark rates? How do we manage the transition? What do we do now? At Refinitiv, we have the answers. Our expert teams are available to support customers every step of the way, offering advice and guidance. And our software provides a world-beating range of data streams and analytics that will help inform your every step during this transition, including Fixing, ISDA Fallback spreads, Inter Dealer Broker data on Derivatives (OIS, Basis Swaps, Cross Currency Basis Swaps), exclusive Sonia Term Rates, Realised Risk Free Rates, Derived Zero Curves, new Risk Free Rates FRNs and Loans.

To find out more about how Refinitiv can support you throughout the LIBOR transition, please get in touch with us.

Above: change is almost here

ABOUT REFINITIV

Refinitiv, an LSEG (London Stock Exchange Group) business, is one of the world's largest providers of financial markets data and infrastructure. With \$6.25 billion in revenue, over 40,000 customers and 400,000 end users across 190 countries, Refinitiv is powering participants across the global financial marketplace. We provide information, insights, and technology that enable customers to execute critical investing, trading and risk decisions with confidence. By combining a unique open platform with best-in-class data and expertise, we connect people to choice and opportunity – driving performance, innovation and growth for our customers and partners.

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