

LIBOR Transition

Market update:
September 16-30, 2020

457 days to December 31, 2021

1 Highlights

No credit-sensitive SOFR spread in sight

What happened? The Bank Policy Institute [held](#) a virtual symposium on credit-sensitive benchmark rates, continuing the discussion that has been at the center of the FRB NY's credit-sensitivity group [workshops](#) over the past months. The workshops were convened in response to concerns about the suitability of SOFR as a lending rate, which had been voiced by a number of regional banks that fear SOFR might not accurately reflect their funding costs — especially in stress periods.

The FRB NY's Nathaniel Wuerffel [provided](#) opening remarks, highlighting the strengths of SOFR as an alternative to USD LIBOR and summarizing the efforts of the credit-sensitivity group workshops. The panel discussions that followed explored the different viewpoints held by lenders, borrowers, academics and trade organizations. In its [summary](#) of the event, the Bank Policy Institute noted that amid what were at times stark differences in opinions, there was general agreement among participants that it remains highly unlikely that a credit-sensitive benchmark or dynamic credit spread — that could be applied to SOFR — will become available prior to LIBOR's anticipated cessation at year end 2021.

Our take: Time is running out. There is certainly an argument to be made that a credit-sensitive spread would simplify some aspects of the transition for a number of institutions. Loan pricing, for example, might require alternative approaches in the absence of a dynamic credit spread. The reality is, however, that it's very unlikely that such a credit spread will be ready for use anytime soon.

Regulators have long made clear that there aren't any readily available means to guarantee the continued publication of LIBOR beyond year-end 2021. The use of SOFR as an alternative to USD LIBOR isn't as much a binding mandate as it is a way for firms to manage the risks associated with

1 - Highlights

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LIBOR's likely cessation. Practically speaking, institutions should push ahead in the transition away from LIBOR under the prudent assumption that any dynamic credit spread that could emerge will not become available prior to LIBOR's cessation. In fact, it isn't certain that such a spread will emerge at all. The Bank Policy Institute's event underlined the emotional nature of the topic, one on which different stakeholders have strong views and legitimate concerns. Some banks have been vocal about wanting to price loans in a way that dynamically reflects their costs of funds. On the other hand, borrowers are questioning why they should bear their lenders' interest rate risk. A solution supported by market consensus certainly does not appear to be in the immediate future.

In time, however, compromise solutions might emerge. A choice of SOFR as the lending rate now does not imply that efforts to develop a credit-sensitive benchmark rate or incremental spread need to be abandoned. In fact, several smaller banks have already indicated they would continue to work toward recommending a solution. Given the effort required to build broad support for a solution, however, it is becoming clear that work on the transition from LIBOR is unlikely to come to a conclusion once LIBOR becomes unavailable. Even today, as firms are planning for and implementing changes to models, processes and systems, they should proactively consider the implications of the possible business need to support multiple benchmarks and different spread adjustments simultaneously at some point in the future.

Switch of convention for sterling swaps from LIBOR to SONIA: Take 2

What happened? The Financial Conduct Authority (FCA) and Bank of England (BOE) (once again) [urged](#) interest rate swap liquidity providers and interdealer brokers to change the convention for quoting sterling interest rate swaps from LIBOR to SONIA. The revised target date for the switch has been identified as October 27, 2020.

The regulators had made a [first attempt](#) to encourage such a switch in the first quarter of this year, but amid the onset of the pandemic and associated market volatility, that attempt was not successful.

Our take: The size of the GBP LIBOR swap market is significant, with some weeks exceeding \$1 trillion in traded notional. A switch in quoting conventions to SONIA should result in an increase in SONIA swaps trading and further promote SONIA as the market standard across derivatives markets.

While the transition from LIBOR is primarily market

driven, the FCA and BOE's announcement serves as a reminder that regulators continue to play an important role in enabling the transition. The switch in sterling swaps convention represents a case in which the regulator can catalyze concerted changes in market structures — something that may be hard for a small number of market participants to agree to do independently.

ISDA's revised IBOR Fallbacks Protocol timetable

What happened? ISDA's latest quarterly report [noted](#) that the effective date of the upcoming IBOR Fallbacks Protocol "will not occur before the second half of January 2021." ISDA also [updated](#) its LIBOR landing page to clarify that it expects to launch the protocol in October, with two weeks' notice. The protocol will go into effect three months after launch.

ISDA CEO Scott O'Malia [noted](#) that the association had sent a [letter](#) on the revised timing of the protocol's anticipated effective date to the BOE and the Financial Stability Board (FSB). In the communication, ISDA reminded regulators that the launch of the protocol was dependent on positive feedback from the various antitrust authorities. ISDA also confirmed that potential statements on future dates for the cessation or non-representativeness of LIBOR would result in the freeze of spread adjustments, even if those statements were to come prior to the protocol effective date.

Our take: The highly anticipated release of the IBOR Fallbacks Protocol is critical to providing the seatbelts for the transition at the time of LIBOR's cessation, but doesn't actually change the terms of contracts or associated cash flows until the cessation date. As a result, the overall transition timeline remains unchanged.

It is unclear whether the delay in the effective date of the protocol will have an impact on the timing of a possible announcement by the FCA or ICE Benchmark Administration (IBA) by year end 2020 on the future non-representativeness (and effective cessation) of LIBOR. Arguably, such an announcement prior to the protocol coming into effect might encourage some institutions to sign the protocol, as such an announcement would trigger the calculation — and locking — of the credit spread adjustment intended to address the tenor and credit basis between LIBOR and the replacement rates.

Having a known spread adjustment value at the time of signing the protocol would provide certainty on the potential outcomes and valuation impacts at the time of LIBOR's cessation. Derivatives pricing appears to reflect an expectation of a possible announcement late

in 2020 or early in 2021, broadly consistent with the expected effective date of the ISDA protocol.

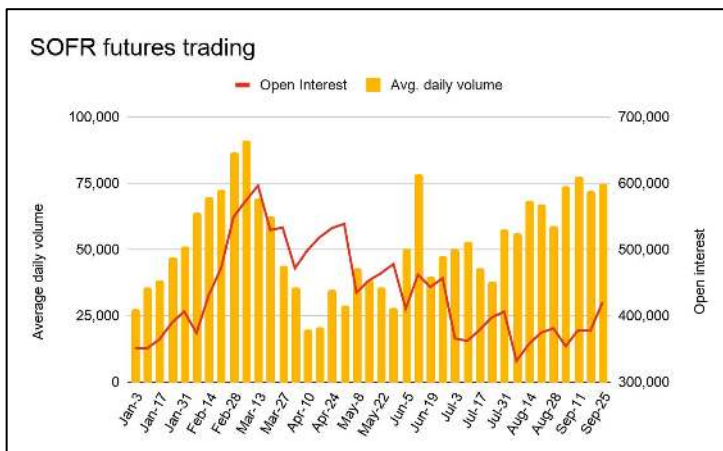
Regulators, alternative reference rate working groups and other industry groups have repeatedly urged market participants to sign the protocol once it becomes effective. At this point, we would expect that most firms have made significant progress in building organizational consensus around a plan of action with respect to signing the protocol once it becomes available. While many market participants are likely to adopt the protocol, there may be some that are either unable or less willing to do so, requiring bilateral negotiations to remedy existing contracts. For example, the protocol may not be an effective solution for derivatives that require the benchmark fixing to be known in advance of the period, rather than a backward-looking benchmark that is applied in arrears, as is the case with the fallback rates employed in the protocol. As a result, a proactive transition of LIBOR-based exposures in advance of LIBOR's anticipated cessation will remain a critical part of firms' strategies. Even with respect to transactions that fall within the scope of the protocol, firms may see benefits of proactively transitioning contracts on terms they can agree on with their counterparties.

UPDATE (Oct 1, 2020): The US Department of Justice (DOJ) has [issued](#) a formal business review letter to ISDA, stating that it does not intend to challenge the proposed IBOR Fallbacks Proposal on the grounds of antitrust concerns. Having received this confirmation from the DOJ, ISDA is now expected to solicit similar feedback from antitrust authorities in other jurisdictions, a process it had previously [estimated](#) to take one to two weeks. It now seems likely that the protocol will be made available to key market participants "in escrow" by mid-October, paving the way for an official launch date at the end of October.

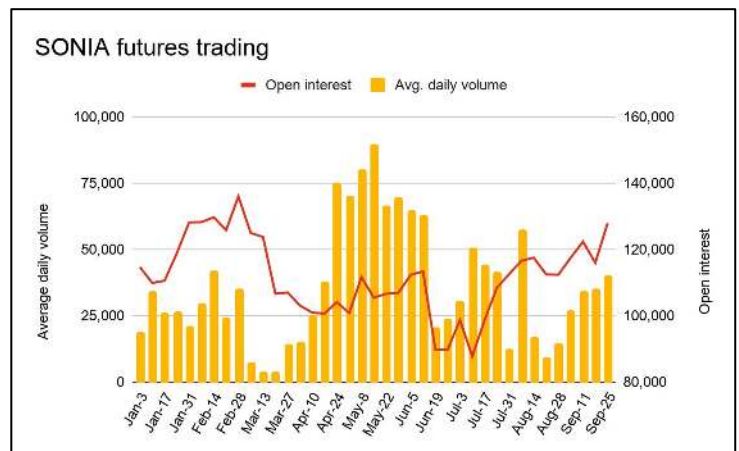
PwC Thailand LIBOR Transition Webinar

2 RFR adoption: Derivatives

Futures and options



Source: CME, ICE (accessed September 30, 2020)

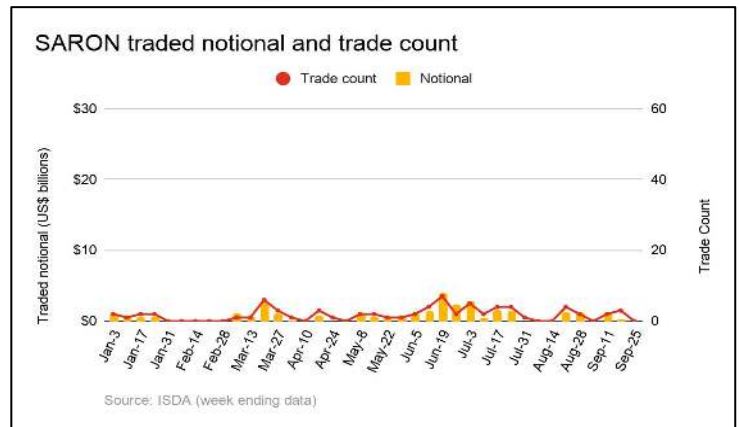
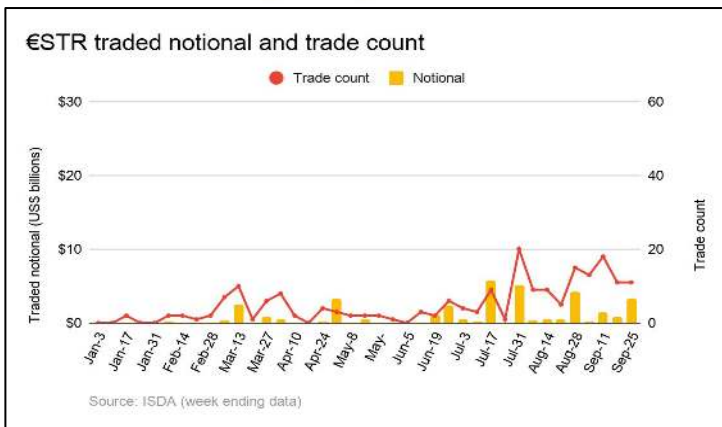
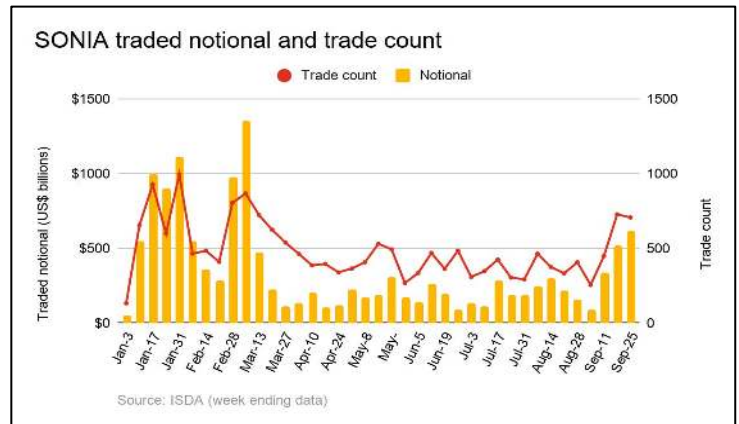
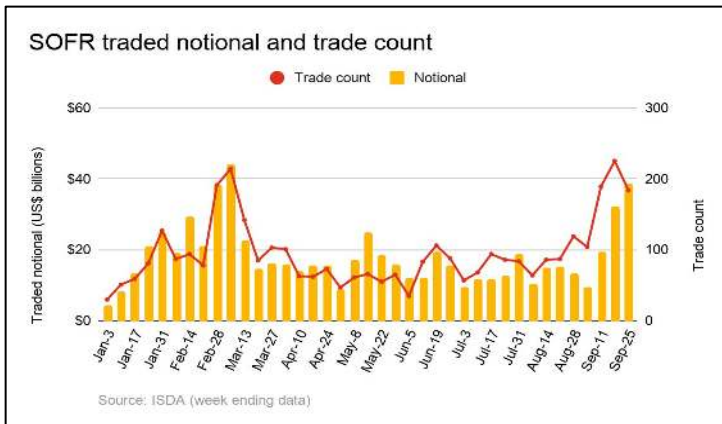


Source: CME, LCH, ICE (accessed September 30, 2020)

Our take

Average daily trading volumes over the past month have been climbing steadily toward levels last seen in February. Open interest has followed that trend and increased to its highest levels in three months. Most of that increase in open interest was seen in 3M SOFR Futures traded at the CME, which has eclipsed that in 1M contracts for the past two months. Historically, open interest had been higher in 1M contracts than in 3M contracts. SONIA futures trading continued to increase in both volume and open interest, primarily driven by an increase in trading of 3M contracts at both CME and ICE. Last week marked the fifth consecutive week-over-week increase in trading volumes.

Swaps trading



Our take:

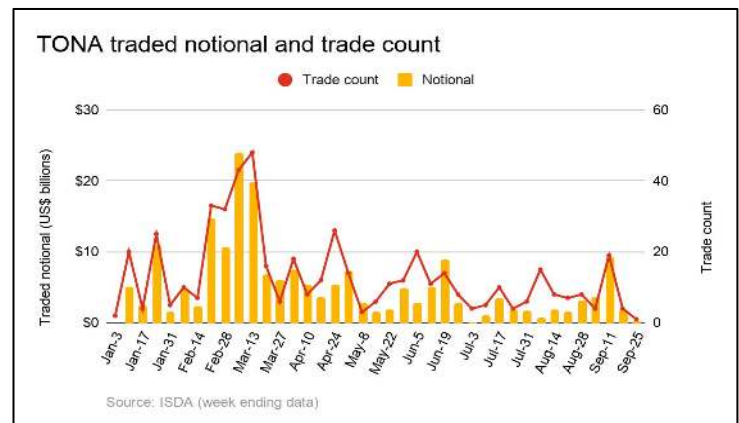
In the run up to the SOFR PAI and discounting switch SOFR swaps trade counts and notional outstanding has increased steadily. In fact, trade counts in the week ending September 18 saw a new all-time high, with 225 contracts being traded. Notional outstanding has followed that increase, and is now again approaching the levels previously seen at the end of February.

We've seen a similar increase in SONIA swaps trading, where both trade counts and notional outstanding over the past two weeks have been higher than at any point during the past six months.

While notional outstanding in RFR swaps continues to be concentrated in maturities of less than one year, the highest number of SOFR and SONIA contracts are traded in maturities of one-to-five and over five years, respectively.

The LCH [announced](#) that SwapAgent had processed the first SONIA/SOFR cross-currency basis swap, a deal between the Bank of America and Lloyds.

In Malaysia, CIMB Bank and Standard Chartered Bank [announced](#) the completion of the first MYR KLIBOR - USD SOFR cross-currency basis swap transaction.



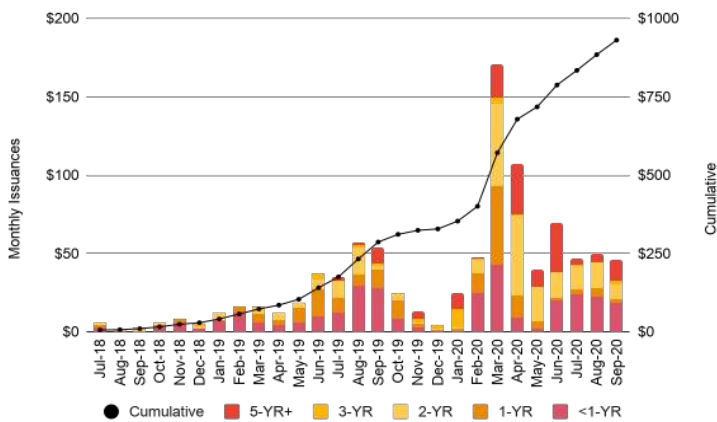
Source: analysis.swapsinfo.org
(Interest rate and credit derivatives weekly trading volume: Week ending September 25, 2020, accessed September 30, 2020)

3 RFR adoption: Cash products

FRN issuances (as of September 30, 2020)

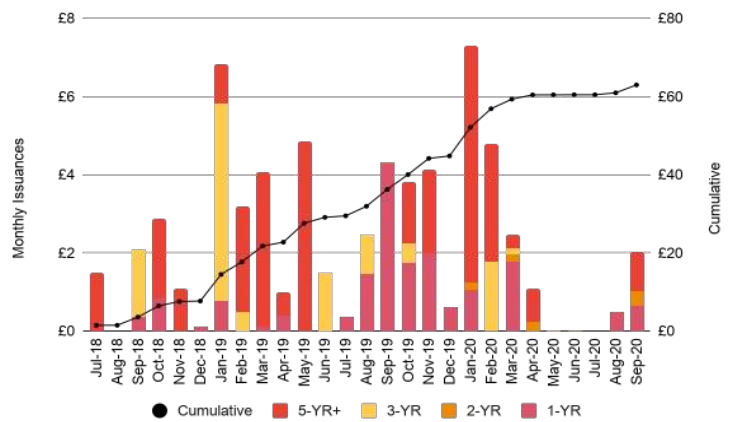
SOFR FRN issuances (in billions)

- In the second half of September, issuances by private sector firms outpaced those by GSEs, while issuances in the first two weeks of September came from GSEs. September's total of just over \$46 billion nearly mirrors activity seen in July and August.
- Over half of issuances in September — just over \$25 billion — have come in maturities of two years or longer.



SONIA FRN issuances (in billions)

- It appears that activity in the SONIA FRN market has returned — at least for now. The total of over £2 billion in issuances in September marks the highest monthly total since the onset of the pandemic outside of Asia in March of this year.
- As SONIA has firmly established itself as the standard for GBP FRN issuances, more than half of issuances to date have come in maturities of five years or longer.



Source: Bloomberg

There have been a total of €3.9 billion in **€STR FRN issuances** since the rate was first published in October of last year, with all issuances in maturities of three years or less.

Notable cash product issuances and other RFR adoption

RFR	Issuer	Detail	Resources
SOFR	Korean Development Bank	Became the first Asian institution to issue SOFR bonds in the US market.	Press Coverage
	Freddie Mac	Continued its offerings of SOFR-based K Certificates.	Press Release
SONIA	NatWest	Extended its first SONIA-based project finance loan to renewable energy firm Innova Energy.	Press Release
	Cinven	The private equity firm is looking to issue an insurance premium ABS backed by a mix of retail and commercial loans, with all tranches referencing SONIA.	Press Coverage
	Coventry Building Society	Amended the terms of its covered bond program to facilitate the program's transition from GBP LIBOR to SONIA.	Press Release
SORA	DBS / ICBC	Extended the first club loan to agriculture company Olam.	Press Release
SARON	Schwyzner Kantonalbank	Became the latest Swiss bank to switch its reference rate for residential and commercial mortgages to SARON.	Press Release (in German)

For additional detail on employed conventions and other parameters of recent RFR-based loans, see the LMA's [frequently updated list](#) of RFR referencing syndicated and bilateral loans.

4 Publications at a glance

Alternative reference rate working groups

Alternative Reference Rates Committee (ARRC)

- [Published](#) its newsletter for August - September 2020.

WG on Sterling RFRs

- [Updated](#) its roadmap to reflect the expectation for market makers to begin quoting sterling IR swaps in SONIA from October 27 on.
- Continued its release of education videos. Topics include [SONIA's background](#), [credit adjustment spreads](#), [legal and documentation aspects](#), [impacts on lending agreements](#) and [recommended next steps](#). Supporting slides [are available](#) on the working group's website.
- [Wrote](#) to ICE Benchmark Administration (IBA) to understand the administrator's view on how LIBOR cessation or non-representativeness might impact the IBA's GBP LIBOR ICE Swap Rate.
- [Published](#) its September 2020 newsletter.

NWG on Swiss Franc Reference Rates

- [Published](#) an executive summary of its September 29, 2020 meeting. Among other agenda points, FINMA noted that the volume of CHF LIBOR tough legacy contracts appeared to be "not an existential issue."

Steering Committee for SOR Transition to SORA (SC-STs)

- Held a [webinar](#) on tax and accounting issues related to the transition to SORA. Supporting presentation slides are available [here](#).

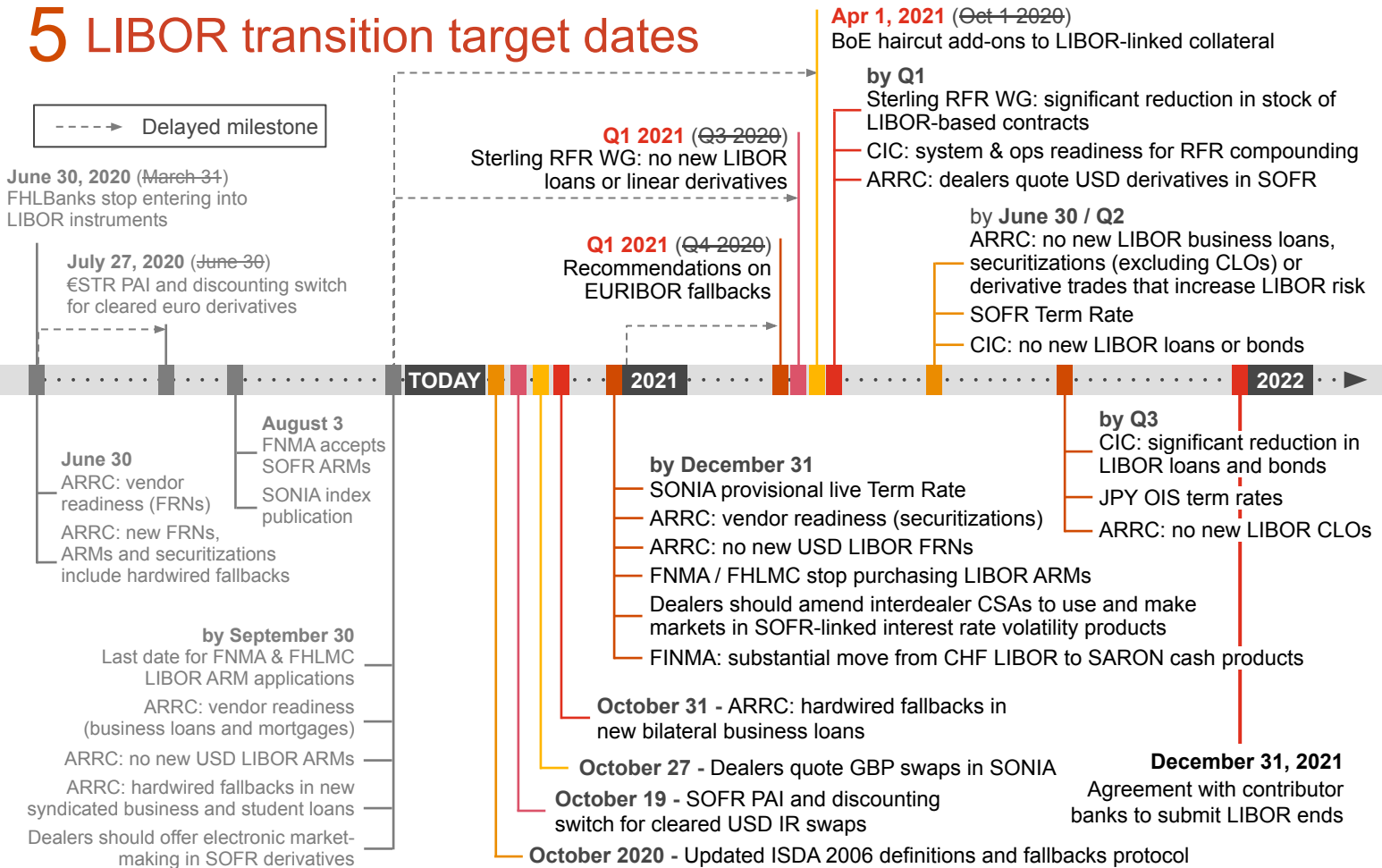
Regulators

- **FCA/BOE:** [Encouraged](#) interest rate swap liquidity providers and interdealer brokers to change the convention for quoting sterling interest rate swaps from LIBOR to SONIA from October 27 on.
- **BOE:** [Held](#) a webinar in collaboration with the Association of Corporate Treasurers (ACT), the Confederation of British Industry (CBI) and the FCA to provide needed insights and practical steps to corporates as part of the transition from LIBOR. The BOE's Andrew Hauser [provided](#) opening remarks at the webinar. [Reiterated](#) in a brief research note that recent market volatility further highlighted LIBOR's weakness as a benchmark rate.
- **FCA:** [Published](#) an updated Regulatory Initiatives Grid. The transition from LIBOR remains a critically important initiative. [Published](#) a summary of available LIBOR transition resources, recommended actions and considerations for different types of market participants. The page is expected to be updated periodically.
- **FRB NY:** Michael Held, Executive Vice President and General Counsel, [spoke](#) at a recent industry event, stressing the need for market participants to proactively transition away from LIBOR.
- **ESMA:** Chair Steven Maijor [spoke](#) on the state of interest rate benchmark reform at a recent industry event, again stressing that ESMA has no immediate plans to discontinue the publication of EURIBOR.
- **Nebraska Department of Insurance:** [Confirmed](#) that companies would be allowed to hold basis swaps received as part of the SOFR discounting switch for a period of one year, in order to facilitate the orderly unwinding of such swaps.

Industry groups, infrastructure providers and other items

- **CME:** [Begun](#) publication of CME Term SOFR prototype rates. Held a [dress rehearsal](#) for the upcoming PAI and discounting switch to SOFR.
- **Bank Policy Institute:** [Recapped](#) its virtual symposium on credit-sensitive benchmark rates, which continued the discussion that has been at the center of the FRB NY's credit-sensitivity group [workshops](#) over the past months. The FRB NY's Nathaniel Wuerffel had [provided](#) opening remarks at the event, highlighting the strengths of SOFR as an alternative to USD LIBOR and summarizing the efforts of the credit-sensitivity group workshops to date.
- **ISDA:** [Published](#) a summary table of how the fallbacks in its amended documentation would function for different products. [Updated](#) its FAQs on IBOR Fallback Rate Adjustments and [summary](#) of interest rate reform related workstreams. [Announced](#) a revised timetable for the publication of the upcoming IBOR Fallbacks Protocol in its latest quarterly report. The report also includes an [interview](#) with the HKMA's Howard Lee. [Updated](#) its benchmark reform landing page to reflect the revised protocol timetable. Sent a [letter](#) on the revised timing of the IBOR Fallbacks Protocol to the BOE and FSB. Additional commentary from ISDA CEO Scott O'Malia is available [here](#). [Posted](#) the recording of a webinar on collateral changes for USD and euro derivatives. Supporting slides are available [here](#).
- **LSTA:** [Reported](#) on the (presumably) first syndicated loan using hardwired fallback language. [Presented](#) on the [operational readiness](#) of the loan and CLO markets at a recent industry conference. [Published](#) proposed changes to its Par Confirmation standard terms and conditions (STC) to reflect that RFR loan facilities should calculate cost of carry based on the respective RFR. Comments are requested by October 16, 2020.
- **SIFMA:** Held a [webinar](#) discussing how operations professionals need to prepare for the transition to alternative reference rates.
- **LMA:** [Released](#) (registration required) a recording of a LIBOR panel session at its recent virtual syndicated loans conference.
- **LCH:** [Announced](#) that LCH SwapAgent had processed the first SONIA/SOFR cross-currency basis swap. [Published](#) its first indicative portfolio for its compensating SOFR discounting swap auction.
- **Freddie Mac:** [Announced](#) that it was evaluating the potential impact of LIBOR being declared non-representative prior to its official cessation on legacy CMO bond that used the "BBA Method."
- **Ginnie Mae:** [Announced](#) that it would restrict the eligibility of LIBOR-based ARMs and HMBS issuances for pooling into securitizations beginning January 1, 2021.
- **Federal Farm Credit Banks Funding Corporation:** [Announced](#) an offer to exchange FRNs maturing after January 31, 2022 for newly issued bonds containing ARRC's recommended hardwired fallback language.

5 LIBOR transition target dates



John Garvey

Global LIBOR Transition Lead
john.garvey@pwc.com

US

John Oliver

US LIBOR Transition Lead
john.m.oliver@pwc.com

Chris Kontaridis

Partner, US - Contract Remediation
chris.kontaridis@pwc.com

Justin Keane

Principal, US - Banking & Capital Markets
justin.keane@pwc.com

Jeremy Phillips

Partner, US - Asset Management
jeremy.a.phillips@pwc.com

Jessica Pufahl

Partner, US - Insurance
jessica.m.pufahl@pwc.com

Maria Blanco

Principal, US - Banking & Capital Markets
maria.t.blanco@pwc.com

Gaurav Shukla

Principal, US - Capital Markets
gaurav.shukla@pwc.com

UK

Andrew Gray

UK LIBOR Transition Lead
agray@pwc.com

Nassim Daneshzadeh

Partner, UK Client & Markets Lead
nassim.daneshzadeh@pwc.com

Karyn Daud

Partner, UK Solutions Lead
karyn.daud@pwc.com

Shazia Azim

Partner, UK - Insurance
shazia.azim@pwc.com

Fiona Lehane

Partner, UK - Asset Management
fiona.m.lehane@pwc.com

Menicos Kouvaros

Partner, UK - Banking & Capital Markets
menicos.i.kouvaros@pwc.com

CA

Rajesh Urathu

Partner, CA
rajesh.urathu@pwc.com

Jim Buckley

Managing Director, CA
b.jim.buckley@pwc.com

EMEA

Dirk Stemmer

EMEA LIBOR Transition Lead
dirk.stemmer@pwc.com

Tina Balzli

Partner, Switzerland
tina.balzli@ch.pwc.com

APAC

Sergey Volkov

APAC LIBOR Transition Lead
sergey.volkov@pwc.com

Tetsuya Adachi

Partner, Japan
tetsuya.adachi@pwc.com

Alfredo Martinez

Partner, Australia
alfredo.martinez@pwc.com

Yura Mahindroo

Partner, Singapore
yura.k.mahindroo@pwc.com

Ilka Vázquez

Partner, Hong Kong
ilka.t.vazquez@hk.pwc.com

Stefan Beyers

Partner, South Africa
stefan.beyers@pwc.com

Sandeep Srivastava

Partner, Middle East
sandeep.srivastava@pwc.com

Ruchi Sharma

India LIBOR Transition Lead
ruchi.sharma@pwc.com

Bum Hong

Partner, Korea
bum.hong@pwc.com

Sinsiri Thangsombat

Partner, Thailand
sinsiri.thangsombat@pwc.com

Eric Lin

Managing Director, Taiwan
eric.h.lin@pwc.com

Song (David) Hu

Senior Manager, China
david.s.hu@cn.pwc.com