

# LIBOR Transition

Market update: August 16 - 31, 2020

**487** days to December 31, 2021

## 1 Highlights

### ARRC fallback language for bilateral business loans and technical appendix to syndicated loan conventions

**What happened?** The ARRC published an update to its recommended fallback language for new bilateral LIBOR business loans. As was the case for syndicated loans, the hardwired fallback approach has been revised to replace adjusted compound SOFR with adjusted simple SOFR (i.e., daily calculation without compounding) as the second step in the waterfall behind term SOFR. The update also removes the amendment approach, which would require parties to negotiate a new reference rate upon LIBOR cessation as an alternative and expands the permissiveness of the early opt-in trigger allowing parties to replace LIBOR with SOFR prior to LIBOR's official cessation. In an update to the hedged loan approach (an option that facilitates alignment between a credit agreement and related swap agreements), the ARRC included a benchmark rate floor (on the adjusted rate).

The committee also published a technical reference document in support of its recently released recommendations for syndicated loan conventions. The document includes discussions on the different conventions for calculating interest that had been considered and includes a series of supporting spreadsheets demonstrating examples for calculating daily cash flows and accruals under the various conventions.

**Our take:** The ARRC's updated fallback recommendations for bilateral business loans, just like the previously released fallback language and conventions for syndicated business loans, reflect the broad spectrum of feedback, benefits and challenges market participants have articulated with respect to how the transition from LIBOR to SOFR in business loans should be operationalized. The recommendations do not represent a single, one-size-fits-all approach, but rather a range of options for market participants to consider as they

## 1 - Highlights

- ARRC fallback language for bilateral business loans and technical appendix to syndicated loan conventions
- Phase 2 conclusion of IASB's benchmark reform project
- ARRC guides for LIBOR ARMs and student loans
- Monetary Authority of Singapore's SORA FRN
- JIBAR no more

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***How should asset managers be thinking about the upcoming LIBOR transition?***

September 15, 2020 at 1:00 PM (ET)

devise a strategy that aligns to their business model, specific needs and operational capabilities. On the flip side of that provided optionality lies the realization that market participants will likely need to accommodate a number of different conventions. This is especially true of the different approaches to calculating interest (characterized by the ARRC as “essentially de minimis”). With firms having the flexibility to choose between different conventions and approaches that meet their needs and respond to differing needs of their borrowers without the fear of facing significant economic differences, it is difficult to imagine that any one convention will quickly emerge as a unified, common industry standard.

Many firms are currently establishing the operational capabilities to transact in RFR loan products. Rather than trying to solve for their one preferred solution and settling on a single convention, firms should devise a strategy that allows for flexibility in conventions. That may include the development of tactical solutions to create the optionality to employ different approaches tailored to different lenders’ needs and potentially emerging industry standards.

### Conclusion of IASB’s benchmark reform project

**What happened?** The IASB concluded Phase 2 of its project on benchmark reform and [published](#) amendments to IFRS, addressing issues that arise once an existing benchmark is replaced with an alternative reference rate.\* The amendments follow the Phase 1 guidance issued in September 2019, which provided temporary relief from applying specific hedge accounting requirements. The Phase 2 amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16:

- allow updating the effective interest rate for changes in the basis for determining contractual cash flows of financial assets, financial liabilities and lease liabilities that are required by interest rate benchmark reform, avoiding the recognition of an immediate gain or loss;
- provide relief from certain hedge accounting requirements for changes to the designation required by interest rate benchmark reform. This means hedge relationships will not have to be discontinued solely because of the reform, but any ineffectiveness needs to be recorded; and
- require companies to make additional disclosures on the effects of benchmark reform to help investors understand how companies are managing such effects and the associated risks.

The reliefs are limited to changes that are required by interest rate benchmark reform, which means that any change has to be necessary as a direct consequence of benchmark reforms and that the new basis for the cash flows has to be economically equivalent to the old basis. The Phase 2 amendments, application of which is mandatory, are effective for periods beginning after January 1, 2021. However, early application is permitted.

The European Financial Advisory Group (EFRAG) promptly [issued](#) a draft endorsement [letter](#), comments to which are imminently due by September 7. On that day, EFRAG will also [hold](#) a public outreach event to get feedback on its draft endorsement.

**Our take:** The finalization of the IASB’s guidance marks another milestone among various regulators’ efforts to provide relief from the impacts of reference rate reform and should allow for a smooth transition to new benchmarks without disruption from an accounting perspective. We anticipate early adoption by a number of institutions to facilitate voluntary transitions onto RFR loans later this year.

It will be important for companies to consider the scope of the IASB’s amendments as they finalize their strategies and playbooks for the remediation of legacy contracts tied to LIBOR. Any effort to amend or renegotiate contract language will need to be conscious of the guardrails that limit the type of changes that qualify for relief. Additionally, depending on potential differences in timing of changes to cash instruments and corresponding derivative contracts, hedge designations may need to be amended more than once — such changes should be monitored carefully. As is the case with many other cross-functional interdependencies, companies will need to facilitate communication and alignment between the various workstreams managing the transition away from LIBOR.

In the US, the FASB issued its own amendments earlier this year, with other regulators proposing relief with respect to tax impacts or initial margin requirements related to swaps trading. The objectives of the reliefs granted by the FASB and IASB generally align, as both seek to avoid disruption as a result of changes stemming from benchmark reform efforts.

There are, however, a number of mechanical differences that firms need to be aware of, such as the optional nature of FASB’s relief that may be applied on a topic by topic or, for some expedients, on an individual hedging relationship basis.

## ARRC guides for LIBOR ARMs and student loans

**What happened?** The ARRC [published](#) transition resource guides for legacy adjustable rate mortgages (ARMs) and private student loans referencing LIBOR. The guides contain summaries of available reference information, suggested timelines, considerations for transition impacts and sample templates to support firms in transitioning legacy contracts from LIBOR to alternative reference rates.

The guides complement previously issued guidance on fallback language, conventions for the use of SOFR in ARMs and the LIBOR transition playbook for SOFR-indexed ARMs published jointly by Fannie Mae and Freddie Mac earlier this year. In seeking to provide assistance to a broad set of stakeholders, the guides provide considerations for borrowers, lenders, vendors, servicers, investors and other stakeholders.

**Our take:** The timing and operational path from LIBOR to SOFR for new issuance of conventional ARMs is well-defined by now, thanks to guidance issued by the GSEs and the ARRC. The released resource guides provide a useful summary of existing material, but do not answer some of the still outstanding questions market participants are seeking clarity on. For instance, the ARRC has yet to lay out recommended guidelines on how to implement the proposed 1-year transition period from LIBOR to SOFR for consumer products, which is intended to allow for a more gradual change in interest rate payments for consumer loan rate transitions. Market participants are also awaiting direction from the Federal Housing Administration (FHA) and Ginnie Mae on how LIBOR's cessation will affect legacy (and new) government mortgage loans and MBS products. As the majority of reverse mortgage loans and securities are indexed to LIBOR, more guidance will be required to assist the various stakeholders across both the forward and reverse government mortgage loan product life cycles in the transition away from LIBOR.

The ARRC's document should constitute required reading for all participants, especially for servicers. Amid competing priorities such as assisting borrowers with the adjustment of repayment plans related to the current crisis and an expected high volume of borrowers rolling off of forbearance plans in early 2021, servicers need to accelerate their planning and execution of LIBOR transition plans as soon as possible. With regulators (including CFPB) now actively engaged with preparing for LIBOR's cessation, servicers need to approach the coming transition fully apprised of the changing regulatory environment. Servicers should not underestimate their role in the

transition from LIBOR, both in regard to their responsibilities to communicate changes in reference rates to borrowers and the level of understanding of contractual provisions within their portfolios that is required to do so.

## Monetary Authority of Singapore's SORA FRN

**What happened?** The Monetary Authority of Singapore (MAS) has [auctioned](#) off S\$500 million in floating rate notes (FRNs) tied to the Singapore Overnight Rate Average (SORA), the recommended alternative to the Singapore Interbank Offered Rate (SIBOR) and Singapore Swap Offer Rate (SOR).

This marks the first in a series of expected FRN issuances referencing the recently [announced](#) SORA index published by the MAS. The MAS FRN employs compounded averaging with a 2-day backward shifted observation period, which allows the coupon payment to be known before the end of the interest period.

**Our take:** The FRN issuance follows the transition timeline proposed by the SOR to SORA Steering Committee to drive the development of the SORA market in Singapore. We expect that these FRN issuances, the next of which is scheduled for September 8, 2020, will act as catalyst for promoting additional SORA-linked cash product issuances in the market.

It remains to be seen whether the MAS' chosen convention serves as an indication for an evolving market standard for issuances of FRNs tied to the new RFRs. Up to now, FRN issuances by financial institutions and GSEs tied to other RFRs such as SONIA and SOFR have employed a variety of different conventions, including a 5-day backward shift or a payment delay in recent issuances of SOFR FRNs. Similarly, a recent consultation by the US Treasury on the possible issuance of a SOFR FRN [showed](#) a market preference for use of a backward shift. As the US Treasury continues to explore the possibility of a 1-year SOFR FRN, the successful example set by the MAS — albeit in a much smaller market — could well accelerate the momentum for a similar issuance in the US market.

## JIBAR no more

**What happened?** The South African Reserve Bank's (SARB) Market Practitioners Group Risk-Free Reference Rate Work Stream [published](#) its recommendations for alternative reference rates to replace the Johannesburg Interbank Average Rate (JIBAR). The group proposed the development of both an unsecured overnight rate based on call deposits and a secured overnight rate based on the current

government bond repo market. SARB supports the sequenced adoption of these alternatives, giving initial preference to the adoption of the South African Rand Overnight Index Average (ZARONIA) as the preferred unsecured candidate to replace JIBAR in cash and derivative instruments. The South African Secured Overnight Financing Rate (ZASFR) was endorsed as the preferred secured overnight rate.

**Our take:** The formal recommendations for preferred unsecured and secured alternative reference rates should provide clarity to the South African market on the path forward for local benchmark rate reforms. The calculation methodology underlying ZARONIA broadly aligns with that employed for other unsecured overnight rates proposed as alternative reference rates in other jurisdictions. As a result, local banks should have some familiarity with the mechanics of operationalizing such a rate. The alignment of the recommended alternative reference rates and overall transition roadmap with that employed for other, major currencies should support the adoption of alternative rates in South Africa, while allowing local market participants to apply the learnings from transition efforts in other parts of the world as they look to manage the risks associated with the transition away from JIBAR.

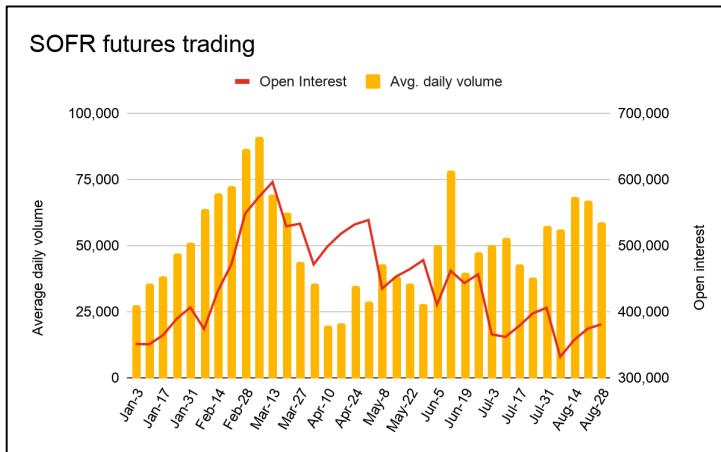
## How should asset managers be thinking about the upcoming LIBOR transition?

Join our upcoming webcast on September 15, 1:00-2:00PM ET

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## 2 RFR adoption: Derivatives

### Futures and options

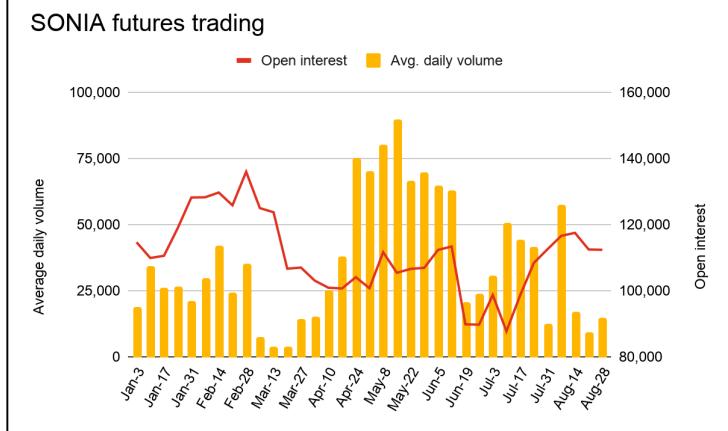


Source: CME, ICE (accessed August 31, 2020)

### Our take

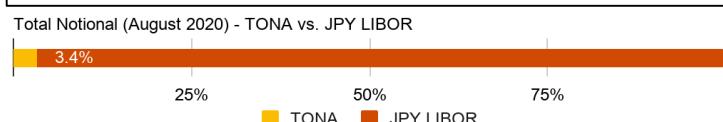
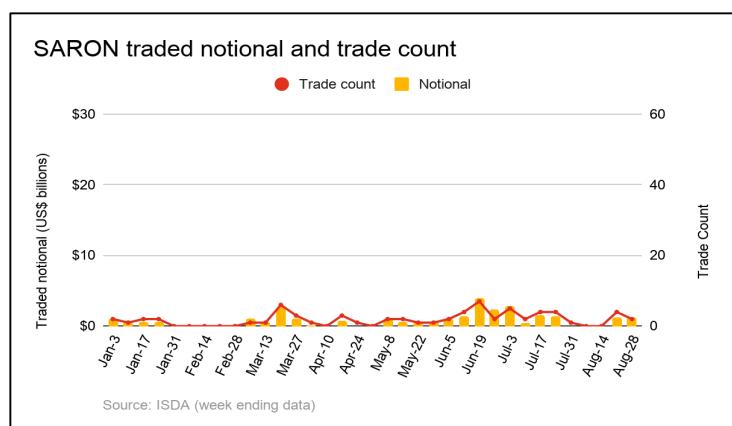
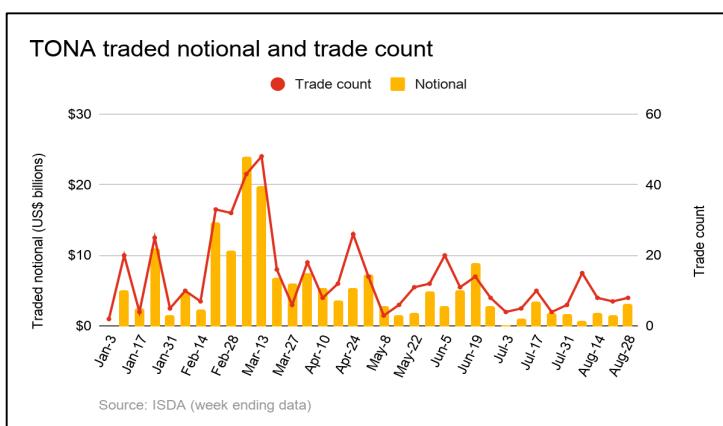
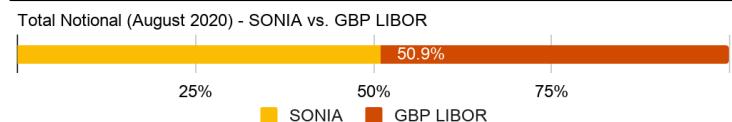
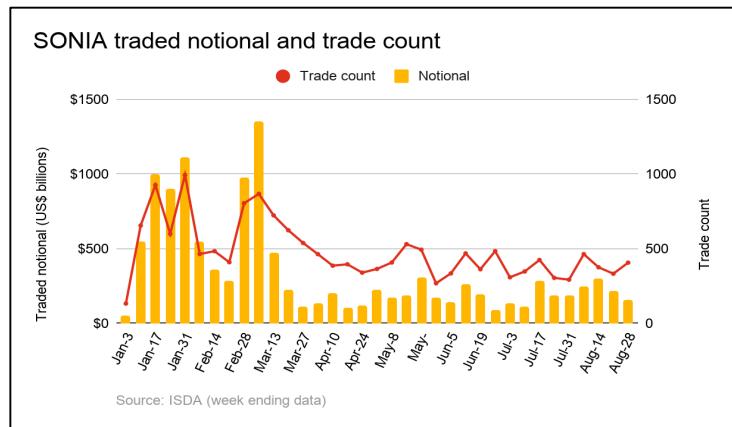
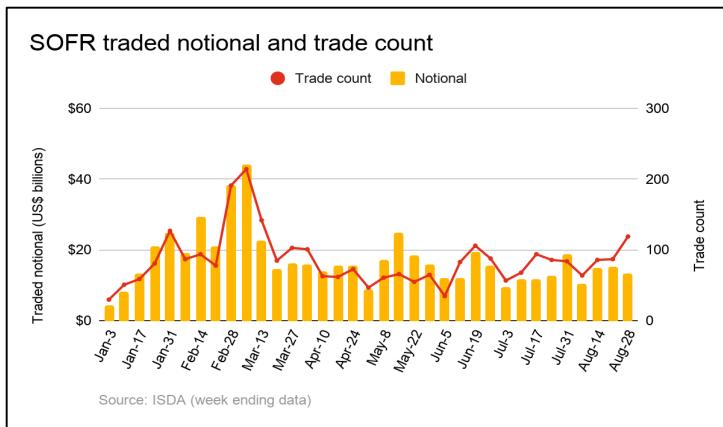
Open interest in SOFR futures is slowly catching up to increases in trading volumes seen over the past few weeks. 3M SOFR Futures in particular have seen several high volume trading days over the past two weeks, with both the CME and ICE setting single day volume records in 3M products. But even with average trading volumes almost at levels similar to those in February, trading of SOFR futures remains a small fraction of those in USD LIBOR.

Not much changed in trading of SONIA futures, where daily average volumes have struggled to reach the record levels seen in May. Trading is concentrated almost entirely in 3M contracts; trading volumes at ICE are now again consistently higher than those at the CME, which briefly eclipsed those at ICE during a spike in trading at the beginning of the month.



Source: CME, LCH, ICE (accessed August 31, 2020)

## Swaps trading



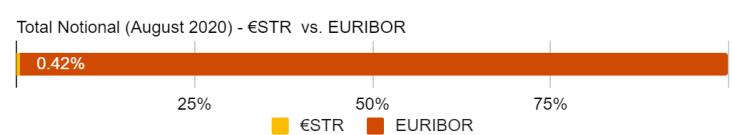
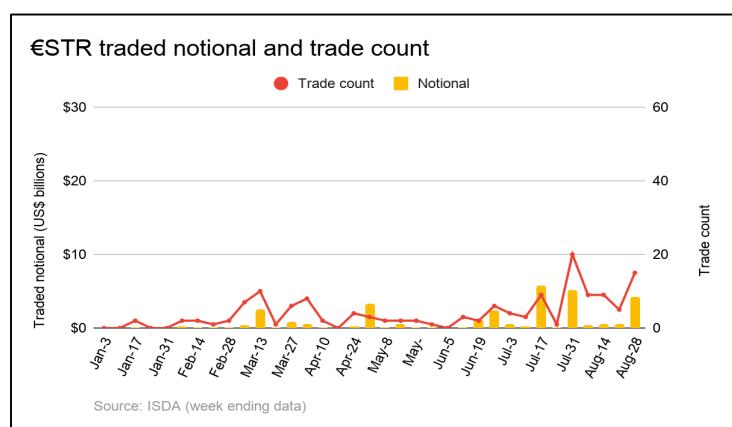
### Our take:

The €STR price alignment interest (the interest paid on collateral) and discounting switch completed in July has not yet led to a significant increase in €STR trading volumes, likely in part due to the lack in floating rate loans or debt issuances tied to €STR.

There has been a slight uptick in SOFR swaps trading volumes, which over the past week saw their highest levels since February of this year.

Trading volumes and outstanding notentials in other RFR swap products, including SONIA, TONA and SARON, remained largely unchanged — both with respect to absolute trade counts, notentials and percentage of the overall swap trading conducted in RFRs vis-a-vis LIBOR.

In Thailand, Kasikornbank (KBank) and CIMB Thai Bank completed the first swap derivatives transaction based on the Thai Overnight Repurchase Rate (THOR), the recommended alternative to THBFIIX.

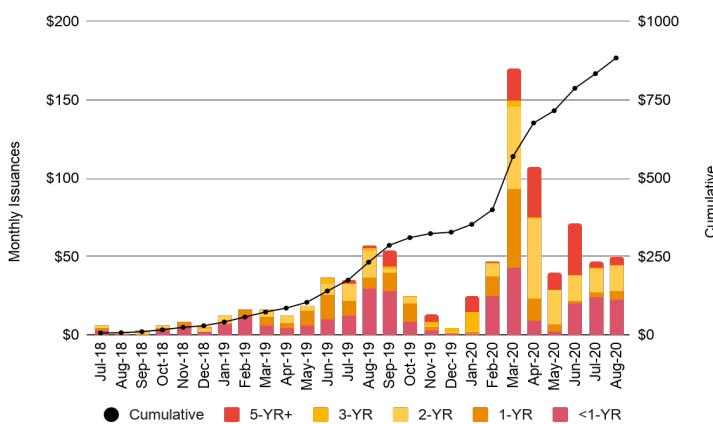


### 3 RFR adoption: Cash products

#### FRN issuances (as of August 30, 2020)

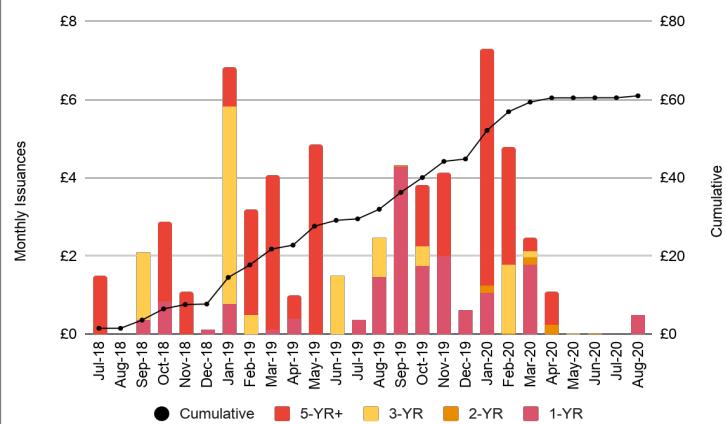
##### SOFR FRN issuances (in billions)

- Issuances in August eclipsed those in July. The 100 individual issuances for a combined \$50 billion represent the second-highest number of issuances in any month other than March of this year. While many of the issuances in March and April took place in longer maturities, July and August saw popularity return to maturities of one year or less.



##### SONIA FRN issuances (in billions)

- There continue to be few GBP FRN issuances, as firms turn to cheaper financing options. Unsurprisingly, issuances due to be issued in early September include two offerings originating outside of the UK, including a £1 billion FRN from the European Investment Bank.



Source: Bloomberg

**€STR FRN issuances** have been slow to pick up. There have been a total of €3.9 billion in 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	Eximbank	Its \$100 million SOFR FRN issuance was the first of its kind in South Korea and only the third in Asia.	<a href="#">Press Coverage</a>
SORA	OCBC Bank	The Singaporean bank has begun offering home mortgage loans based on 30-day compound SORA.	<a href="#">Product Page</a>
DBS	DBS Bank	The bank issued the first SORA-based loan in the amount of S\$200 million to agribusiness group Wilmar International.	<a href="#">Press Release</a>

# 4 Publications at a glance

## Alternative reference rate working groups

### Alternative Reference Rates Committee (ARRC)

- Published an update to its recommended fallback language for new bilateral LIBOR business loans.
- Published a technical reference document in support of its recommendations for syndicated loan conventions. The document includes discussions on the different conventions for calculating interest that had been considered, including a series of spreadsheets with examples of calculating daily cash flows and accruals under the various conventions.
- Published an updated version of its recommended Best Practices that expands on the committee's recommendation to adhere to the upcoming ISDA IBOR Fallback Protocol. The ARRC now explicitly recommends that dealers and other firms with significant derivatives exposures sign the protocol during the escrow period.
- Released transition resource guides for legacy [LIBOR ARMs](#) and LIBOR-based [private student loans](#).

### WG on Sterling RFRs

- Published a statement on standard market conventions for sterling loans based on compounded in arrears SONIA, recommending the use of a 5-day lookback without observation shift. Supporting documents include a [presentation](#) on the different loan conventions, summary [results](#) of an earlier market survey and a [spreadsheet](#) of worked examples.

### South African Reserve Bank's (SARB) Market Practitioners Group Risk-Free Reference Rate Work Stream

- Recommended the adoption of both an unsecured O/N rate based on call deposits and a secured O/N rate based on the current government bond repo market as replacements for the Johannesburg Interbank Average Rate (JIBAR). SARB supports the sequenced adoption of these alternatives, giving preference to the adoption of the South African Rand Overnight Index Average (ZARONIA) as the preferred candidate.

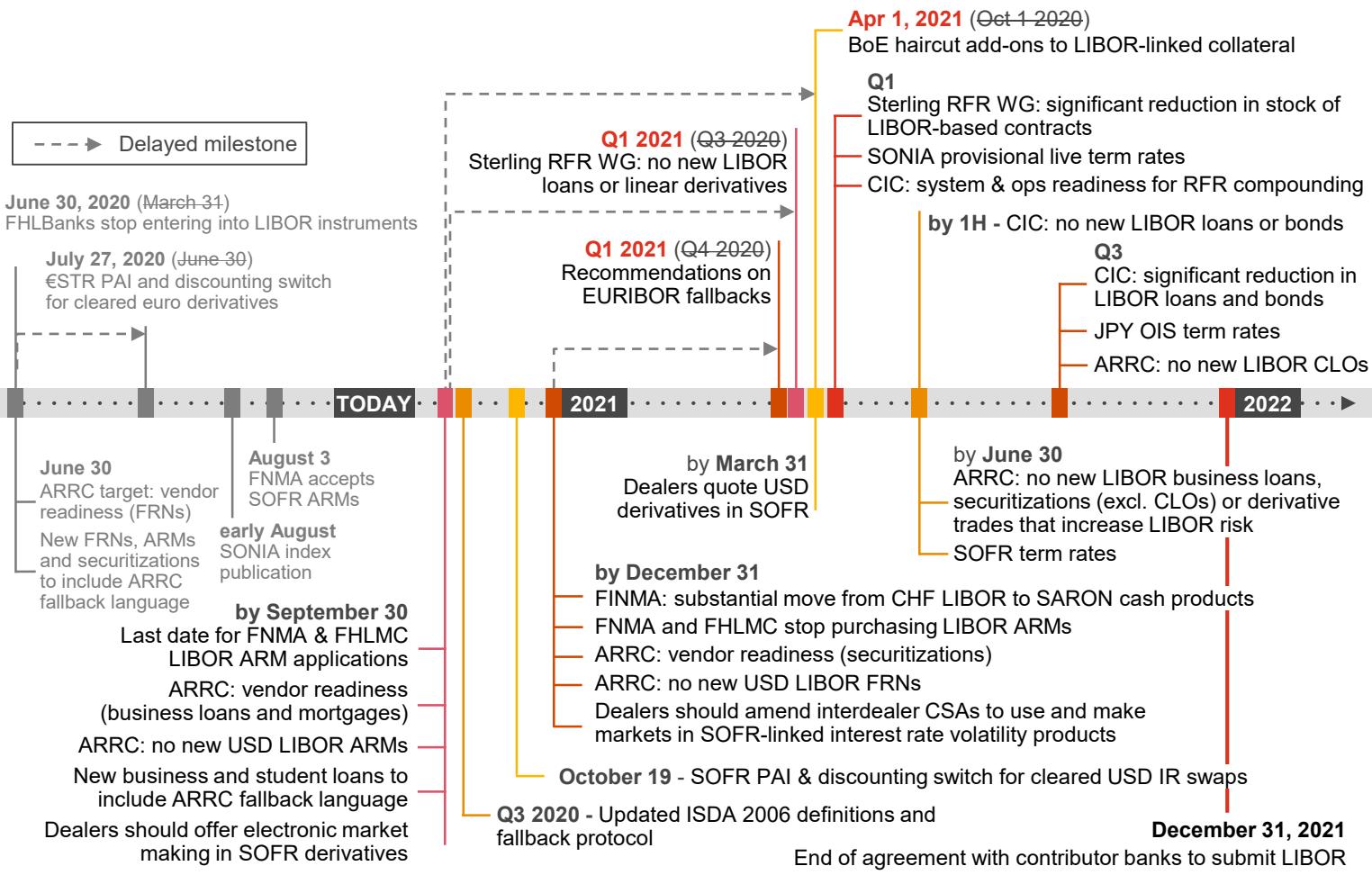
## Regulators

- IASB:** Concluded phase two of its project on benchmark reform, [publishing](#) updates to IFRS Standards relating to changes to contractual cash flows, hedge accounting and disclosures. The Board also [released](#) its proposed taxonomy updates to reflect the new disclosure requirements.
- EFRAG:** Promptly [issued](#) a draft endorsement [letter](#), comments to which are due by September 7. On that day, EFRAG will also hold a [public outreach event](#) to get feedback on its draft endorsement.
- FRB NY:** The Credit Sensitivity Group held its latest [workshop](#) on August 27 to hear from a diverse set of borrowers on their perspectives. The FRB NY also [posted](#) meeting minutes and materials from its third workshop held on August 12. Turned to [social media](#) to remind industry participants that only 500 days remain to transition away from LIBOR.
- CFTC:** The divisions of Swap Dealer and Intermediary Oversight, Market Oversight and Clearing and Risk have each [issued](#) revised no-action letters that provide additional relief to swap dealers and other market participants. Earlier this year, the ARRC had communicated a number of considerations for edits to the CFTC's initial no-action letters.
- U.S. Treasury:** At the latest US Treasury Borrowing Advisory Committee Debt Manager Solimine [provided](#) an update on the potential issuance of a SOFR-indexed FRN. Respondents to an RFI issued earlier this year were broadly supportive of such an issuance, indicating a preference for daily SOFR compounding and quarterly coupon payments.
- Monetary Authority of Singapore (MAS):** [Issued](#) a S\$500 million FRN tied to SORA.
- Association for Banks in Singapore (ABS) & Steering Committee for SOR Transition to SORA (SC-STS):** Sent a [letter](#) to the committee's membership recommending prompt adherence to ISDA's upcoming IBOR Fallback Protocol.
- People's Bank of China:** [Published](#) a [white paper](#) on its participation in global benchmark reform initiatives, laying out its plans to promote the use of interbank repo rates as part of the transition away from LIBOR.

## Industry groups, infrastructure providers and other items

- ISDA (w/ UK Finance):** [Published](#) their comment letter to the HRMC's consultation on taxation impacts from LIBOR transition. The organizations are urging the HRMC to allow market participants to act on basis of the draft guidance, given the ever shortening time window to transition away from LIBOR.
- ICMA:** [Published](#) the minutes of the July 29 meeting of the LIBOR Trade Association Working Party.
- LSTA:** [Announced](#) it was starting a new project aimed at developing amendment forms to facilitate the transition of legacy loans away from LIBOR. In a related blog post, the association also [suggested](#) that compound SOFR may not be compatible with a SOFR index.
- LMA:** [Published](#) (member-access only) a note on its Revised Replacement of Screen Rate Clause, including a supplement intended to provide a mechanism for renegotiation of an agreement.
- ICAEW:** [Published](#) a checklist of 10 accounting- and disclosure-related questions finance should be asking about LIBOR transition in light of IFRS amendments related to benchmark reform.
- London Stock Exchange:** [Published](#) a brief update on its (and its subsidiaries') efforts to support the transition from LIBOR and the status of GBP LIBOR FRN issuances.
- Freddie Mac:** [Reminded](#) market participants of the critical upcoming LIBOR transition dates.

# 5 LIBOR transition target dates



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