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Interest Rate Benchmarks Reform

Background

Interbank Offered Rates (IBORs), including the London Interbank Offered Rate (LIBOR), the Euro Interbank Offered Rate (EURIBOR) and the Hong Kong Interbank Offered Rate (HIBOR), are widely accepted interest rate benchmarks. IBORs have been commonly adopted in financial markets to calculate interest rates or other payments in a broad range of financial products, such as loans, bonds and derivatives, and are frequently used as the basis for valuations by market participants.

The G20 instructed the Financial Stability Board (FSB) in 2013 to undertake a review of the major interest rate benchmarks and plans for reform in order to ensure that the interest rate benchmarks are robust and used appropriately. In 2014, the FSB published a report recommending:

- strengthening IBORs, where possible; and
- identifying alternative near-risk-free rates (RFRs) for use as alternative reference rates, and where suitable, to encourage market participants to transition to new, appropriate RFR contracts.

Why are IBORs being reformed?

IBORs are generally calculated from the estimates submitted by a selection of banks in relevant financial markets, and are meant to reflect the price of interbank funding markets. In some financial markets, banks no longer fund themselves in the interbank market to the same extent as they used to. This has led to declining transaction volume in the markets that underpin certain IBORs, creating growing concern about them no longer being representative.

Amongst all current IBORs, LIBOR has been the most widely used interest rate benchmark in financial products for decades. In 2017, the Financial Conduct Authority (FCA), the UK authority that regulates LIBOR, stated that after 31st December 2021, it will no longer compel banks to continue making LIBOR submissions. Consequently, it is expected that the number of LIBOR submissions by banks could fall significantly, reducing the representativeness of LIBOR. More importantly, it is expected that LIBOR will cease to be published after 2021. This has had the effect of creating a clear deadline for market participants to end their reliance on LIBOR.

Global authorities consider that it is necessary to transition away from LIBOR and certain other IBORs are also undergoing reforms. This is commonly known as IBOR Transition. Market participants are expected to implement proper processes in managing the transition, as not doing so could result in significant market disruption in relation to selecting and calculating the replacement rate.

What will be the Alternative Reference Rates (ARRs) replacing IBORs?

LIBOR covers financial products denominated in five currencies: British Pound (GBP), Euro (EUR), United States Dollar (USD), Japanese Yen (JPY) and Swiss Franc (CHF). Transition away from LIBOR requires its replacement by new alternative reference rates (ARRs) for each relevant currency.

For certain other IBORs, in response to regulators' expectation, near-risk-free rates (RFRs) are also being developed in the relevant markets for use as ARRs in relation to those IBORs.

A key objective of the transition is the creation of an interest rate market based on actual transactions leading to a more transparent, reliable and representative interest rate market. Market consensus is that RFRs (which are principally overnight interest rates based on actual transactions) would be used as ARRs for IBORs.

Various working industry groups comprising public and private sector representatives across jurisdictions were established in order to identify appropriate RFRs as ARRs for different markets. These working groups have now identified the ARRs.

A summary of certain major ARRs identified by these working groups and the anticipated approach for transition are set out in the table below.

Currency	IBOR	ARR	Working Group	Anticipated Approach
Pound Sterling	LIBOR	Sterling Overnight Index (SONIA)	Working Group on Sterling Risk-Free Reference Rates	Transition is necessary.
Euro	LIBOR	Euro Short Term Rate (€STR)	Working Group on Euro Risk-Free Rates	Transition is necessary.
US Dollar	LIBOR	Secured Overnight Financing Rate (SOFR)	Alternative Reference Rates Committee	Transition is necessary.
Japanese Yen	LIBOR	Tokyo Overnight Average Rate (TONA)	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks	Transition is necessary
Swiss Franc	LIBOR	Swiss Average Rate Overnight (SARON)	National Working Group on Swiss Franc Reference Rates	Transition is necessary.
Hong Kong Dollars	HIBOR	Hong Kong Dollar Overnight Index Average (HONIA)	Treasury Markets Association	Multiple-rate approach - HIBOR continues alongside HONIA
Singapore Dollars	SIBOR	Singapore Overnight Rate Average (SORA)	Association of Banks in Singapore and the Singapore Foreign Exchange Market Committee	Multiple-rate approach - SIBOR continues alongside SORA

IBORs and ARRs: What are the differences?

There are a number of fundamental differences between IBORs and ARRs. It is important to consider these differences carefully in order to understand the implications brought about by the transition to ARRs. Some of the key differences are highlighted in the table below.

IBORs	ARRs
Based largely upon expert judgement by banks making relevant IBOR submissions	Based mainly upon transaction data in active markets
Forward-looking rates	Backward-looking rates calculated using historic transaction data
Available in multiple tenors	Currently overnight rate only, but term rates for some ARRs are in development
Incorporate a bank credit risk premium	Do not incorporate a bank credit risk premium
A liquidity premium is applied to longer term rates	No liquidity premium is applied

ARRs are overnight interest rates based on a backward-looking calculation methodology, with reference to actual transactions. They have little or no credit risk, and are without liquidity premium due to their overnight nature.

On the other hand, IBORs are forward-looking term interest rates for unsecured interbank loans with a number of different tenors (which, for instance, could be up to 12 months or more in the case of LIBOR), with an embedded credit spread. Longer term IBORs may incorporate higher liquidity premium.

How do the benchmark rate differences impact customers?

Forward looking v. backward looking:

- As an IBOR has forward-looking term structure, in a usual loan contract referencing an IBOR with interest payable in arrears, each interest payment amount can be fixed and known at the beginning of the corresponding interest calculation period. Borrowers may find it useful for cash-flow forecasting.
- However, for a typical loan referencing an ARR with interest payable in arrears, as the ARR is backward–looking and based on actual transaction data, the interest rates for the corresponding interest period would be based on the compounded ARR accruing in arrears during the interest period. In such case, the interest rate and interest amount to be paid may only be known at or near the end of the interest period and current discussions are in relation to having an observation period which commences and ends 5 business days prior to the relevant interest period.

Transition from existing rate (IBOR) to a new rate (ARRs):

- In economic terms, IBORs (which incorporate credit risk premiums) are usually higher than corresponding ARRs, which are nearly risk-free rates.
- Using ARRs (which are overnight rates) for interest calculation for a term (say, 3 months) requires appropriate rate conversion methodology to achieve proper calculation for the term interest period.
- When parties replace a reference to an IBOR with the relevant ARR in an existing contract, the bank credit risk premium element of the rate is removed. In order to preserve the economic equivalence for the new contract, a spread adjustment may need to be added to an ARR for proper transition.

- Conversion of an overnight rate to be applied to a term interest period may also require changes to the existing contract term.
- Standard-setting bodies and industry organisations are making progress on formulating the relevant calculation methodology and the credit spread adjustment. We are closely monitoring the developments and assessing the necessary changes to the existing contracts.

What potential risks should customers be aware of?

Some interest rate benchmarks are being discontinued or reformed. In particular, it is expected that LIBOR (the most commonly used IBOR in financial markets) will cease to be published after 2021. When LIBOR ceases to be published (and possibly before then), it would not be an appropriate rate to reference as a benchmark for many transactions.

Some IBORs other than LIBOR are also undergoing reforms due to applicable regulatory requirements and industry practice. It is not yet certain how and to what extent their reformed calculation methodology would differ from their existing forms.

Accordingly, if customers have any existing contracts referencing IBORs or enter into any new contracts referencing IBORs, they should be aware of the following:

- It is expected that LIBOR will cease to be published and that it will be necessary to determine an alternative reference rate, or ARR. It is important to note that ARRs currently identified by the relevant industry bodies behave differently from LIBOR in many respects;
- The reform of some IBORs may result in different calculation methodologies and different performances than in the past;
- Financial contracts referencing IBORs (in particular those linked to LIBOR) may require adjustment to incorporate necessary fallback provisions (i.e. contractual provisions for alternative reference rates instead of the IBORs in question) and any other appropriate amendments such as spread adjustments;
- The occurrence of any of the above may: (1) materially impact the economic value of the relevant financial transactions (for example, the value of certain financial products that you may hold), and (2) result in a mismatch between the rate referenced in the relevant financial instrument and the customers' other financial instruments, including potentially those that are intended as hedges. It may also cause accounting or tax issues, or have other unforeseen or adverse consequences.

The above list only highlights some of the matters pertaining to IBOR Transition and should not be treated as an exhaustive list of all the relevant risks.

IBOR Transition will impact certain BEA products and services that BEA customers now hold or use and those that may be provided in the future. The extent of the impact will depend on a range of factors, which include the particular IBOR adopted in the products or services, evolving market and industry developments, changes to valuations, legal documentation and the terms and conditions of the products or services. We are closely monitoring the developments. We may provide more information on the changes when there is greater certainty on the agreed new benchmarks, their methodology and the transition process.

Customers are advised to conduct their own independent assessment and analysis of the potential consequences of any relevant risks, including the potential market, financial, legal, accounting, tax and regulatory impact on their financial contracts and transactions. BEA will continue to engage with its customers on market developments and on the potential risks and implications that IBOR Transition may have on the financial products you currently have with BEA. You are encouraged to get in touch with your usual BEA contact if you wish to discuss any thoughts or concerns.

What is BEA's approach to IBOR Transition?

BEA has started and will continue to evaluate and address the risks associated with IBOR Transition, with specific considerations for product and client exposures.

BEA greatly values its customers and will proactively engage, communicate, and increase levels of education with impacted customers. Achieving smooth and orderly transition in partnership with customers is BEA's priority.

To align its approach with industry practice and the regulatory expectation, BEA is closely monitoring the developments of the interest rate benchmark reform both in the UK and internationally, and has updated and implemented its transition programme and action plans as appropriate.

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What can customers do to prepare for IBOR Transition?

Customers are encouraged to stay up-to-update on the latest developments of IBOR Transition. It is important that you are aware of what the changes from IBORs to ARRs might mean to you, including any financial, accounting, legal and taxation impact. The initial steps that customers may wish to take to prepare for the transition include:

- Understanding your exposures to IBORs by review of your existing documentation and any existing fallback provisions;
- For LIBOR referenced contracts in particular, assessing how existing transactions may behave if reliance on LIBOR is phased out or when LIBOR publication ceases;
- Evaluating the impacts on you due to the differences between current IBOR references and the potential ARRs which may be incorporated in contractual documentation in the future;
- Considering what other impacts IBOR Transition may have on you or your business;
- Engaging professional advisors (financial, accounting, tax, legal or other) as you consider appropriate to help you on the assessment of the impact due to the transition;
- Getting in touch with your usual BEA contact to discuss your specific products and how they might be affected.

The above is not an exhaustive list and is only intended to outline some of the initial steps you may consider.

More information

BEA may periodically update this page as appropriate to reflect market developments. For further information on specific BEA products and services you currently have, please get in touch with your usual BEA contact.

For general information on IBOR-related market developments, a non-exhaustive list of websites of external industry bodies or organisation sources is included below:

Financial Stability Board (https://www.fsb.org/)

GBP LIBOR – The Working Group on Sterling Risk-Free Reference Rates (https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor)

EURIBOR - The Working group on euro risk-free rates (https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html)

USD LIBOR – The Alternative Reference Rates Committee (https://www.newyorkfed.org/arrc)

HKD HIBOR – Treasury Markets Association (https://www.tma.org.hk)

JPY LIBOR - Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/)

CHF LIBOR - National Working Group on Swiss Franc Reference Rates (https://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates)

Frequently Asked Questions

Q1: What BEA products are IBOR Transition relevant to?

IBOR Transition is releant to financial products, such as loans, bonds and derivatives, that (1) reference IBOR as a means of calculating interest rates and other payments; and (2) have a maturity date beyond 2021. For BEA, the most common products will be mortgage loans, personal loans, corporate loans and interest rate swaps referencing LIBOR, EURIBOR or HIBOR.

Q2: What is LIBOR? Will LIBOR cease to be available at some point in the future?

London Interbank Offered Rate (LIBOR) is the benchmark interest rate calculated based on the submissions by a panel of banks in London for five currencies (GBP, USD, EUR, CHF and JPY), intended to represent an estimate of how much it would cost a bank to borrow money from other banks in the London interbank market.

The UK authority stated that it would no longer compel panel banks to continue making submissions after 2021. At that time it is expected that LIBOR will cease to be published due to the lack of bank submissions.

Even if some panel banks continue to submit their rates for LIBOR calculation after 2021, it is likely that the LIBOR rate would no longer be a robust and representative benchmark. As such, regulators expect that market participants will end their reliance on LIBOR by the end of 2021, even if it continues to be published. In response to this, various working industry groups comprising public and private sector representatives across jurisdictions have been established in order to identify appropriate alternative reference rates for different markets.

Q3: I have GBP financial products with BEA referencing GBP LIBOR and maturing post-2021. Will my GBP products be impacted by IBOR Transition?

Yes. Since GBP LIBOR will, in all likelihood, cease to be published beyond 2021, it is expected that the market will move towards Sterling Overnight Index Average (SONIA) as an equivalent for GBP LIBOR. The relevant contract referencing GBP LIBOR with us would need to be amended at some stage in the future. If this is the case, we will let you know.

Q4: What is SONIA? Where can I get data on this benchmark?

The Sterling Overnight Index Average (SONIA) is an unsecured overnight rate calculated by the Bank of England from elgible transactions reported to them via their sterling money market daily data collection process in accoardance with the form “SMMD”.

Reformed SONIA has been published since April 2018.

Q5: I have USD financial products with BEA referencing USD LIBOR and maturing post-2021. Will my USD products be impacted by IBOR Transition?

Yes. Since USD LIBOR may cease to be published beyond 2021. It is likely that the market will move towards Secured Overnight Financing Rate as an equivalent for USD LIBOR. The relevant term loan contract referencing LIBOR with us might need to be amended at some stage in the future. If this is the case, we will let you know.

Q6: What is SOFR? Where can I get data on this benchmark?

The Secured Overnight Financing Rate (SOFR) is a secured treasury repo rate. The Alternative Reference Rates Committee, which is the US working group leading the transition away from LIBOR, has selected SOFR as the recommended alternative reference rate for the US. SOFR is calculated based on actual repo transaction data.

SOFR was first published in April 2018 and is published each business day on the New York Fed’s website.

Q7: What is EURIBOR? Will EURIBOR continue to be available in the near future?

The Euro Interbank Offered Rate (EURIBOR). EURIBOR is a daily reference rate published by the European Money Market Institute, representing the rate at which credit institutions in the European Union (EU) can borrow wholesale funds in Euros in the unsecured money markets.

EURIBOR has been reformed for compliance with EU Benchmark Regulation. EURIBOR is not expected to discontinue in the foreseeable future.

Q8: I have Euro financial products with BEA referencing EURIBOR. Will my EURIBOR products be impacted by IBOR Transition?

Currently, as EURIBOR is expected to continue, we do not anticipate that IBOR Transition will result in the replacement of EURIBOR by an alternative reference rate in the existing Euro financial products contracts with us in the near future. As IBOR Transition is still ongoing, if there are any new developments in IBOR Transition which would result in any change to your Euro financial product contract with us, we intend to let you know.

Q9: What is HIBOR? Will HIBOR continue to be available in the near future?

Hong Kong Interbank Offered Rate (HIBOR). This is a benchmark interest rate for Hong Kong Dollars (HKD) and Chinese Renminbi in Hong Kong (CNH), calculated based on submissions by a panel of banks in Hong Kong, intended to represent an estimate of how much it would cost a bank to borrow money from other banks in the Hong Kong interbank market.

There is currently no plan to discontinue HIBOR according to the Treasury Markets Association. HIBOR has been in place for decades and is still well recognised by market participants as a representative and robust interest rate benchmark. Whilst Hong Kong Dollar Overnight Index Average (HONIA) has been identified as the alternative reference rate to HKD HIBOR, it is expected that HKD HIBOR and HONIA will co-exist in the market. Market participants may continue to use HKD HIBOR as an interest rate benchmark for their Hong Kong Dollar financial products.

For financial contracts referencing CNH HIBOR, as HIBOR is expected to continue in the foreseeable future, we do not anticipate that the current IBOR transition would result in the change in the interest benchmark rates in those financial contracts.

Q10: I have Hong Kong Dollar financial products with BEA using HIBOR. Will my HIBOR products be impacted by IBOR Transition?

Currently, as HIBOR is expected to continue, we do not anticipate that the IBOR Transition will result in the replacement of HIBOR by an alternative reference rate in existing Hong Kong Dollar facility contracts with us in the near future. As IBOR Transition is still ongoing, if there are any new developments in IBOR Transition which would result in any change to your HKD facility contract with us, we intend to let you know.

Q11: Where can I find more information on IBOR Transition?

For general market information on IBOR Transition, you may refer to the information available from external industry bodies or organisation sources indicated in the "More Information" section on this webpage.

Q12. What will the impact of IBOR Transition be for me?

If you wish to discuss IBOR Transition's impact on the products you currently have with BEA, please get in touch with your usual BEA contact.

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