# EASTERN AND SOUTHERN AFRICAN TRADE AND DEVELOPMENT BANK (“TDB”)

## IBOR TRANSITION

## Frequently Asked Questions (FAQs)

August 2021

## 1. What is LIBOR?

The London Interbank Offered Rate (LIBOR) is an indication of the average rates at which banks could obtain wholesale, unsecured funding. It is calculated from submissions made by selected panel banks and is published in 5 currencies (British pound sterling, euro, U.S. dollar, Swiss franc and Japanese yen) and it has a range of tenors (Overnight, 1 week, 1, 2, 3, 6 and 12 months). It is published each London business day and is administered by ICE Benchmark Administration (IBA).

LIBOR is the most widely used interest rate benchmark to price or value a wide range of financial products, including corporate and personal loans, mortgages, bonds, securitizations, and derivatives, underlying over USD 370 trillion of transactions globally. Apart from LIBOR, there are a number of other Interbank Offered Rates (IBORs) such as EURIBOR (Euro Interbank Offered Rate) and TIBOR (Tokyo Interbank Offered Rate).

## 2. Why is IBOR being phased out?

The LIBOR methodology is designed to produce an average rate that is representative of the rates at which large, leading internationally active banks with access to the wholesale, unsecured funding market could fund themselves, since the financial crisis banks no longer fund themselves in this way. The decline in the underlying market means that LIBOR is now primarily sustained by the use of expert judgement and estimates and is therefore not supported by actual underlying transactions and could be prone to manipulation. Given the fundamental weaknesses of the calculation methodology, global regulators and market participants began a process of phasing out LIBOR across all currencies and tenors and identifying appropriate alternative benchmark rates. Global markets are therefore gearing towards transition from LIBOR to alternative near-risk-free rates (RFRs), mostly administered by central banks.

## 3. When will LIBOR end?

On 5 March 2021, the IBA, the administrator of LIBOR, and the FCA, the regulatory supervisor of the IBA announced that all LIBOR settings will either cease to be provided by any administrator or no longer be representative:

- After 31 December 2021: all British pound sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month U.S. dollar settings; and
- After 30 June 2023: all the remaining U.S. dollar settings.

## 4. What are the implications on financial markets of LIBOR phasing out?

Given the value of financial products that use LIBOR, phasing out LIBOR has a significant impact on all participants in financial and capital markets globally. Moving from LIBOR to RFRs is a massive undertaking across the financial markets and includes several key undertakings:

- Adoption of new reference rates;
- Change or upgrades in financial software to include the new reference rates;
- Amendments to financial contracts referencing LIBOR;
- Transition Risk management.

## 5. What alternative reference rates have been recommended by industry bodies for each LIBOR currency?

**Summary of the key features of the USD and EURO RFR[1]:**

| **Currency** | **USD** | **EUR** |
|---|---|---|
| **Current IBOR** | USD LIBOR | EURIBOR |
| **Date of current IBOR discontinuation** | 31 December 2021- 1 week, 2 months<br>30 June 2023 - all tenors[2] | EURIBOR has been reformed and will not be discontinued |
| **Alternative RFR** | Secured Overnight Financing Rate (SOFR) | Euro short term rate (€STR) |
| **Secured/ Unsecured** | Secured | Unsecured |
| **RFR Working Group** | Alternative Reference Rates Committee | Working Group on Risk-Free Reference Rate for the Euro Area |
| **RFR Administrator** | Federal Reserve Bank of New York | European Central Bank |

**Other rates***

| **Currency** | **Industry body / organisation recommending alternative rate** | **Alternative rate recommendation and description** |
|---|---|---|
| **British pound sterling**** | SWG on Risk-Free Reference Rates, set up by the Bank of England | SONIA (Sterling Overnight Index Average)<br>Unsecured overnight rate calculated by the Bank of England from eligible transactions reported to them via their sterling money market daily data collection process. Reformed SONIA has been published since April 2018. |
| **Swiss franc** | The National Working Group on CHF Reference Rates set up by the Swiss National Bank | SARON (Swiss Average Rate Overnight)<br>SARON references actual market transactions in the Swiss franc interbank repo market (i.e. secured). It has been published since August 2009. |
| **Japanese yen** | Study Group on Risk-Free Reference Rates | TONAR (Tokyo Overnight Average Rate) |

[1] Other IBORs affected include: Canadian dollar, Swiss franc, British pound sterling, Japanese yen
[2] Based on the IBA announcement of its intentions to cease the publication of the indicated LIBOR tenors.

| | | |
|---|---|---|
| | convened by the Bank of Japan | An uncollateralised overnight call rate. It has been published since 2016. |

**Alternative reference rates are materially different from LIBOR and are calculated using different methodologies. As such they are not direct replacements for LIBOR.*
***Other options for alternative rates may include, in the UK, the Bank of England Bank Rate (commonly known as Base Rate) for sterling products, or a fixed rate or in the USD market, the Prime Rate.*

### 6. What are the main differences between IBORs and RFRs?

- RFRs rely entirely on actual transactional data, whereas LIBOR is a consensus of rates submitted by a panel of banks;
- IBOR rates are forward-looking and have a term element whereas RFRs are based on daily overnight rates and are either calculated by reference to actual historical data (being backward-looking RFRs) or by reference to market expectations of what future daily overnight rates will be, implied from derivatives markets (being forward-looking or term RFRs);
- IBORs include a premium to compensate for bank credit risk whereas RFRs do not price credit risk;
- RFRs do not include a premium on long-dated lending - i.e. RFRs do not compensate lenders for making funds available long-term;
- In most cases therefore, RFRs are lower than their IBOR equivalents and an adjustment spread may need to be added to the RFR to cater for these components. This is known as a Credit Adjustment Spread (CAS);
- With LIBOR, interest payable is predetermined in advance. If using backward-looking RFRs, the interest payable over a period is calculated in arrears using either simple or compounding averaging methodologies. If using forward-looking or term RFRs, interest payable at the end of an interest period can also be pre-determined in advance.

### 7. What are the implications on financial products, including derivatives, and bilateral and syndicated loans?

LIBOR and the alternative reference rates are structurally different. Consider for instance LIBOR and SOFR. LIBOR has a term structure, is an unsecured rate, and contains a credit premium representing the credit risk inherent in interbank lending, is published for different tenors and may not have underlying transactions supporting the rate. SOFR, on the other hand, is an overnight rate, secured (by US treasuries), and almost risk-free rate and is supported by underlying transactions. Given the differences in construction, TDB and other market players expect that all parties should be economically neutral after the transition from LIBOR to a new alternative reference rate. The transition is therefore not intended to change credit premiums or revise economics of a transaction. However, certain adjustments may be required to reflect the differences in both the term nature and interbank lending risk characteristics of LIBOR.

They include:

- **RFRs may not have a term structure** and this can be addressed, in part, by calculating term rates from derivatives on overnight risk-free reference rates. The robustness of such rates will depend on the level of liquidity in the underlying markets;

- **Credit Adjustment Spread** is expected to be added to the new SOFR base rate to capture the difference between LIBOR, which reflects credit risk on an interbank lending basis, and the successor rate (an almost risk-free rate).

Following consultations on the LIBOR transition, ARRC published recommended contractual Hardwired fallback provisions for USD denominated LIBOR-referencing syndicated and bilateral business loans, covering three main parameters:

- **Triggers:** Circumstances that would trigger the replacement of the reference benchmark rate;
- **Benchmark replacement rate:** The rate, or waterfall of rates, that will replace the current benchmark;
- **Credit Adjustment Spread:** Spread added to the replacement rate to account for difference with current rate.

TDB has broadly adopted ARRC's recommendations and will incorporate a hardwired fall-back provision in its existing and new USD denominated LIBOR-referencing financial contracts in connection with its transition from using USD-LIBOR as the primary reference rate for USD lending to SOFR (regardless of the governing law of such financial contracts, i.e. TDB's approach will be to broadly reflect ARRC's recommendations, even in English law governed agreements). TDB will continue to review recommendations from the various industry working groups and organisations such as the LMA as it develops financial contracts during this LIBOR transition period and beyond. TDB will also consider alternative approaches to this where circumstances require (for example, on transactions involving interest rate hedging governed by ISDA documentation, it may be necessary to align triggers and benchmark replacement rates across the hedging and the underlying financial instrument).

### 8. What is the credit adjustment spread (CAS)?

RFRs are economically different to LIBOR. LIBOR includes a measure of term risk and bank credit risk, whereas RFRs do not. Consequently, RFRs are typically lower than LIBOR. To account for this economic difference, an adjustment spread is often applied to the relevant RFR, called the credit adjustment spread (CAS). CAS differs by currency and tenor.

### 9. How is CAS calculated and does the methodology differ between financial products?

Global regulators, industry working groups are working on coordinating transition timelines and methodologies across products, currencies and jurisdictions. However, such regulators and industry groups have not mandated that a particular CAS is appropriate for particular products, currencies or jurisdictions, and they are unlikely to do so.

Many in the derivative and cash markets have adopted a 5-year historic median methodology as between the relevant IBOR and the relevant RFR in order to calculate the relevant CAS.

In the derivative markets ISDA has published an IBOR Fallbacks Protocol (Protocol) and a Supplement to the 2006 ISDA Definitions. The Protocol allows market participants to incorporate the revised fallbacks into their legacy non-cleared derivatives trades with other counterparties that also choose to adhere to the Protocol. TDB has adhered to the ISDA 2020 IBOR Fallbacks Protocol on 17 February 2021.

In January 2020, ARRC launched a market consultation on various spread adjustment methodologies and requested market participants to express their views on which methodology would be best suited to particular cash products. The consultation focused on floating rate notes, securitizations, business loans and consumer products. Based on the responses received, the ARRC recommended a spread-adjustment methodology for cash products based on a historical median over a five-year lookback period that calculates the difference between USD LIBOR and SOFR.

This five-year median spread adjustment methodology mirrors the methodology recommended by the ISDA for derivatives which will harmonize cash products and derivatives agreements that contain similar post-LIBOR fallback language. The five-year median spread-adjustment methodology targets USD LIBOR agreements that have incorporated the ARRC's hardwired fallback language as well as legacy USD LIBOR contracts transitioning to SOFR.

Following the FCA announcement on 5 March 2021, ISDA confirmed an index cessation event for all LIBOR settings. As a result, CAS to be used in its IBOR fallbacks, which are calculated using the 5-Year Historic Median, are now fixed for all British pound sterling, euro, Swiss franc, U.S. dollar and Japanese yen LIBOR settings[3].

In July 2020, ISDA and Bloomberg announced that Bloomberg Index Services Limited (BISL) has begun calculating and publishing fallbacks that ISDA intends to implement for certain key interbank offered rates (IBORs). Calculations published by BISL include the adjusted RFR (compounded in arrears), the spread adjustment and the 'all in' IBOR fallback rates for the following IBORs across various tenors: the Australian dollar Bank Bill Swap Rate (BBSW), the Canadian Dollar Offered Rate (CDOR), Swiss franc LIBOR, EURIBOR, euro LIBOR, sterling LIBOR, HIBOR, euroyen TIBOR, yen LIBOR, TIBOR and U.S. dollar LIBOR.

### 10. How is TDB implementing the transition away from IBOR?

#### a) TDB has adopted an Active Transition approach

TDB has adopted an Active Transition approach as recommended by various industry working groups on the transition. Active transition entails TDB proactively amending underlying financial contracts that reference IBOR, so they reference an RFR and also reflect an appropriate RFR calculation mechanism. This will negate the need to rely on the fallbacks included in the contracts that are triggered by events related to the cessation of IBOR.

[3] ISDA has appointed Bloomberg to publish these spread adjustments and the full list is available here.

## b) When will TDB begin to use alternative reference rates in new loan documentation?

Following the FCA announcement in 2017 and the subsequent confirmation on termination dates on March 2021, TDB is gearing towards piloting new SOFR referencing financial products in 2021 with complete phasing out of new LIBOR referencing financial products by 31st December 2021. The Bank will continually update our customers on internal product development and impact to our customers.

Additionally, TDB is a member of industry forums that allow us to monitor changes in the industry and exchange ideas on implementation of the transition, overcoming challenges and best practice during this time.

As mentioned above, the Bank has adopted recommendations from ARRC and other industry groups in its documentation of USD denominated LIBOR-referencing financial products to incorporate hardwired fall back provisions in the applicable financial contracts, including potential trigger events requiring the use of alternative reference rates and the process to be followed to implement such a switch in reference rates.

## c) How will TDB implement the use of the new alternative reference rates to replace IBOR?

TDB's approach to IBOR transition is guided by the global market's response. On March 5, 2021, FCA announced that they would no longer compel panel banks to make submissions to support all LIBOR settings as such, representative LIBOR rates would likely no longer be available. These cessation dates are:

- After Dec. 31, 2021, for all British pound sterling, euro, Swiss franc and Japanese yen settings, and the one-week and two-month U.S. dollar settings
- After June 30, 2023, for all other U.S. dollar settings

The Bank will communicate with customers whose existing USD denominated LIBOR-referencing loans or financial contracts are expected to mature after 30th June 2023 to amend such financial contracts by incorporating ARRC recommended Hardwired fallback provisions prior to the expected LIBOR cessation date. The Bank will also communicate with affected customers on the use of the new reference rates, changes in calculation methodology, notice periods, interest payment dates amongst other aspects. We will work closely with our customers to anticipate customer queries, share information to make the transition process as efficient as possible.

## d) Syndicated loan facilities

### i. Will the amendments to the reference rate affect TDB's multi-lender transactions?

Yes. USD denominated LIBOR-referencing multi-lender financial contracts maturing after 30 June 2023 will be amended prior to the expected LIBOR cessation date to incorporate the ARRC recommended Hardwired fallback provisions and to reflect the new reference rate - SOFR - for USD denominated transactions. The Bank will communicate with the affected lenders and borrowers regarding the changes to be made to the existing documentation, including costs associated with such changes.

### ii. What is the role of syndicated facility Borrowers and Lenders?

Syndicated facility Lenders and Borrowers will be central to the Active Transition approach. TDB as facility agent will therefore seek Borrower and Lender consent to make the necessary amendments and we will also share with the parties our preferred operational conventions for administering SOFR loans. The rights, interests and obligations of the parties will remain unchanged, and TDB as Agent will facilitate meetings/discussions with all parties as may be required.

### iii. What additional actions is TDB taking as facility Agent?

TDB is approaching our syndicated loan borrowers to sensitise them on the changes that the transition from LIBOR will bring. TDB Agency, Syndications and Legal teams will also be working closely with external counsel to finalise the transitioning of legacy syndicated facilities within industry working groups' recommended timelines.

### e) How is TDB dealing with basis risk that may arise from this transition?

The Bank is closely monitoring the development of RFRs and the resulting risks such as basis risk. The bank is exploring various hedging solutions and other mitigants to manage any basis risk that may arise as a result of the transition.

### f) Is TDB changing its banking software or systems to accommodate the implementation of new reference rates?

The Bank has performed front-to-back reviews of businesses and operations to ensure core banking systems and IT infrastructure impacted by LIBOR transition are identified and remedied. Currently, various system enhancements and upgrades are underway to accommodate the new reference rates.

Based on the expected updates and changes to the systems, the Bank will continue to run its existing banking software based on LIBOR reference rate and commence booking loans linked to RFRs using the same systems once the enhancements are completed and in production. The change in banking software will not increase your cost of doing business with the Bank.

## 11. Can I borrow using forward-looking SOFR as a reference rate?

A lot of work has gone into the development of a SOFR term rate with ARRC publishing a set of key principals here and announcing its formal recommendation of CME Group's forward looking SOFR term rate. With this formal recommendation, a forward-looking SOFR term rate is now available for use in the market.

We have summarised below, the recent milestones achieved as part of the ARRC's 2017 transition plan to a forward-looking SOFR term rate:

- On May 21, 2021, ARRC announced the selection of CME Group as the SOFR administrator and further noted that liquidity in the SOFR derivative market was in clear sight and achievable;
- On 21 July 2021, ARRC announced conventions and use cases for how best to employ the SOFR term rates and successfully transition away from USD LIBOR. The announcement noted that:
  - The term rates will be especially helpful for the business loans market - particularly multi-lender facilities, middle market loans, and trade finance loans—where transitioning from LIBOR to an overnight rate has been difficult. TDB notes that some trade finance products, such as supply chain finance, receivables purchase and discounted letters of credit, work by discounting future cashflows and rely on a term reference rate; the BAFT IBOR Transition Working Group on Suitability of Rates Subgroup highlighted the challenges that the absence of a forward-looking term SOFR rate would have on the USD denominated trade finance market in its white paper published in its May 2020 guidance note, updated in March 2021;
  - The best practice recommendations also support the use of SOFR Term Rates in end-user facing derivatives that hedge cash instruments linked to the Term Rates, and certain securitizations with underlying assets that are themselves tied to SOFR Term Rates.
- On July 26, 2021, interdealer conventions moved to trade SOFR linear swaps in place of USD LIBOR. The Interest Rate Benchmark Reform Subcommittee of the Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee (MRAC) recommended this move as a market best practice modelled after the "SONIA First" best practice in the U.K., and the MRAC adopted that recommendation soon after. The ARRC had previously emphasized that it expected its market indicators for a SOFR term rate would be met once the convention switch was in place, allowing the ARRC to formally recommend the CME SOFR term rates very shortly thereafter;
- The ARRC also endorsed the CFTC MRAC's recommendation that interdealer trading conventions for cross-currency basis swaps between U.S. dollar, Japanese yen, sterling, and Swiss franc LIBOR move to each currency's risk-free rate (RFR) as of September 21, 2021;
- On 29 July 2021, the ARRC announced its formal recommendation of CME Group's forward-looking SOFR Term Rates following the successful completion of the "SOFR First" convention switch in interdealer trading conventions.

Given this development, the Bank will adopt ARRC's recommendation on the use of CME Group's forward-looking SOFR Term Rates. CME Group's term SOFR rates are derived from CME SOFR futures which averaged USD 218 billion (computed based on the value of an equivalent money market instrument with the same dollar-value-of-basis-point) in representative notional per day in H1 2021.

**12. What about EURIBOR (Euro Interbank Offered Rate)?**

EURIBOR has been reformed to comply with the EU Benchmark Regulation and there are no current plans to discontinue it. However, one should be aware that cash fallbacks might need to be strengthened in light of regulatory guidance and some products may transfer to other Euro rates. TDB will therefore continue to offer EURIBOR linked financial products with immediate changes in existing contracts focusing on USD LIBOR contracts.

**13. What should I do and who do I speak to at TDB about the IBOR transition?**

TDB clients should assess the exposure of their contracts, products and services to IBOR, especially those which are expected to mature beyond December 2021. Please also seek independent legal and financial advice on the IBOR transition and how financial contracts you are party to may be impacted.

For questions on TDB's transition, please contact us on tdblibor@tdbgroup.org or speak to your coverage banker. TDB will also communicate with you during this transition period.

Please see important reference links to working groups and industry bodies actively involved in the IBOR transition below:
- Alternative Reference Rates Committee (newyorkfed.org)
- Loan Market Association - the future of LIBOR (lma.eu.com)
- Announcements on the end of LIBOR | FCA
- Transition from LIBOR to risk-free rates | Bank of England
- Working group on euro risk-free rates (ecb.europa.eu)
- Swiss franc: https://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates;
- Japanese yen: https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/
- ISDA: https://www.isda.org/2020/05/11/benchmark-reform-and-transition-from-libor/
- https://itfa.org/itfa-baft-guidance-on-accommodation-of-libor-transition-in-mpas/

**14. What are the key bodies overseeing LIBOR transition globally?**

**British pound sterling and LIBOR**: the Bank of England and the UK Financial Conduct Authority (FCA) oversees LIBOR transition. There is an industry-led Working Group on Sterling Risk-Free Reference Rates (the WG£RFR) that produces guidance and support for both financial and non-financial firms to help with the transition. The Bank of England and the FCA participate in the WG£RFR as ex-officio members and provide administrative support to the group.

**U.S. dollar LIBOR**: the Alternative Reference Rates Committee (ARRC) is determining an alternative benchmark rate. The ARRC is comprised of private market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York.

**Derivatives markets**: the International Swaps and Derivatives Association (ISDA) was mandated by the Financial Stability Board (FSB), a consortium of national and international regulators, to draft fallback provisions, select the fallback rates and mechanisms for the 2006 ISDA Definitions, and develop a plan to amend legacy contracts referencing LIBOR. ISDA published these proposed fallback provisions, fallback rates, mechanisms, and draft amendments on Oct. 23, 2020, in the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol.

**The syndicated loan market**: the Loan Market Association (LMA), a trade association for the Europe, Middle East, and Africa region, works with market participants, other trade associations, and regulators to represent the interests of the syndicated loan market, developing key compounding conventions and standard documentation for risk-free, rate-referencing transactions.

**Abbreviations**

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|---|---|
| ARRC | Alternative Reference Rates Committee |
| BAFT | Bankers Association for Finance and Trade |
| BOE | Bank of England |
| EONIA | Euro Overnight Index Average |
| ESTR | Euro Short Term Rate |
| EURIBOR | Euro Interbank Offered Rate |
| EURO | Single European currency, which replaced the national currencies of nineteen member states of the European Union since 2002 |
| FCA | Financial Conduct Authority |
| FSB | Financial Stability Board |
| IBA | ICE Benchmark Administrator |
| IBOR | Interbank Offered Rate |
| ICE | Intercontinental Exchange - an operator of regulated exchanges, clearing houses and listings venues and publisher of LIBOR |
| ISDA | International Swaps and Derivatives Association |
| LIBOR | London Interbank Offered Rate |
| LMA | Loan Market Association |
| LTSA | Loan Syndications and Trading Association |
| RFR | near risk free rate |
| SARON | Swiss Average Rate Overnight |
| SOFR | Secured Overnight Financing Rate |
| SWG | Working Group on Sterling Risk-Free Reference Rates |
| TONAR | Tokyo Overnight Average Rate |
| USD | United States Dollar |

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