An important message from Barclays regarding benchmark interest rate reform and the transition away from LIBOR

Regulators are driving benchmark interest rate reform

For several years, global regulators and central banks have been driving international efforts to reform key benchmark interest rates to make them more reliable and robust.[1] These reforms are happening in many jurisdictions, such as the United Kingdom, the Euro area, the United States, Switzerland, Canada, Japan, Hong Kong, Singapore and Australia.[2]

A key focus of these reforms is to ensure that widely used benchmarks are credible and robust. Regulators have been clear that this means benchmarks should be based upon transactions to the greatest extent possible.

Perhaps the most commonly known of these benchmarks is LIBOR, the London Interbank Offered Rate[3], which is referenced by trillions of dollars' worth of financial products; including for calculating interest payments on bonds, loans and mortgages.

This note provides a brief, non-exhaustive update about what is going on in this space. We encourage all market participants to stay up to date with developments.

Background on the concerns about LIBOR

Despite reforms in the governance and submission methodology of LIBOR, which now anchor the benchmark in "*transactions to the greatest extent possible*"[4], few transactions in the short-term money market actually occur now as banks have changed the way they fund themselves. Regulatory measures implemented after the 2008 financial crisis, to strengthen banks' balance sheets, have reduced the utility of unsecured interbank borrowing in the money markets. These are the same transactions upon which LIBOR submissions are based.

The Federal Reserve Bank of New York estimates that for US Dollar LIBOR, the most commonly used reference rate upon which some $200 trillion worth of contracts rely, "*on a typical day there are currently around six to seven actual market transactions-totalling about $500 million-that could underpin one- and three-month U.S. dollar LIBOR across all of the panel banks*."[5]

The UK's Financial Conduct Authority ("FCA") has also expressed concerns about LIBOR's future, with the CEO Andrew Bailey commenting:

> "*In our view it is not only potentially unsustainable, but also undesirable, for market participants to rely indefinitely on reference rates that do not have active underlying markets to support them.*"[6]

Developing alternative reference rates

In response to these concerns, global regulators formed currency-specific working groups to assess market conditions, examine alternatives and consider next steps. Members of these working groups include banks, asset managers, insurance companies and corporates. Industry bodies and trade associations representing various segments of the market are also actively engaged.[7] Barclays is supportive of, and is participating in, several of these working groups.

These efforts have resulted in the identification of alternative, 'near risk-free rates' (or "RFRs"), for each of the LIBOR currencies. These alternative rates are based upon larger numbers of transactions. They also have some structural differences to LIBOR. In particular, IBORs are term rates that embed credit risk whereas the RFRs are overnight rates generally viewed as riskless or near risk-free.

Currency	Existing Rate	Alternative Rate	Transaction Type
USD	LIBOR	**SOFR**, Secured overnight financing rate	Secured
EUR*	LIBOR, EURIBOR	**€STR**, Euro short term rate	Unsecured
GBP	LIBOR	**SONIA**, Sterling overnight index average	Unsecured
JPY	LIBOR	**TONA**, Tokyo overnight average	Unsecured
CHF	LIBOR	**SARON**, Swiss average rate overnight	Secured

* The Euro Short Term Rate ("€STR") will replace the Euro Overnight Index Average ("EONIA"), at the end of 2021. No potential cessation date has been given for EURIBOR.

A sense of urgency

Regulators' concerns about the continued use of LIBOR remain elevated. In a key regulatory speech in 2017, Andrew Bailey clearly articulated the continuation of LIBOR was at risk: *"Our intention is that, at the end of [2021], it would no longer be necessary for the FCA to persuade, or compel, banks to submit to LIBOR. It would therefore no longer be necessary for us to sustain the benchmark through our influence or legal powers."*[8]

More recently in 2019, Randal Quarles, Chair of The Financial Stability Board, stressed that the "*Clarity on the exact timing and nature of the LIBOR stop is still to come, but the regulator of LIBOR has said that it is a matter of how LIBOR will end rather than if it will end, and it is hard to see how one could be clearer than that.*"[9]

Though market participants should be mindful that the exact date by when LIBOR will cease to be published may vary by currency, the end of 2021 is not far away.

Challenges to transition

The path to transition away from LIBOR is complex. The various jurisdictions are at different stages of transition and are moving at different speeds towards potentially different outcomes. These differences become more pronounced when taking into account the reforms underway in some of the other, non-LIBOR specific regions.[10]

For example, the working group tasked with identifying alternative rates for interest rate benchmarks in Euro has taken a different approach. No indication has been given that EURIBOR, the Euro Interbank Offered Rate, is likely to cease anytime soon. Rather, the European Commission "*expressed confidence that, with necessary reforms, the EURIBOR had good medium-term prospects*."[11] The reforms are happening now.[12]

It is difficult to imagine a 'one size fits all' approach or solution. Transition will affect both new and existing products referencing these key interest rate benchmarks, and in different ways. The consequences of reform are unpredictable and may have an adverse impact on any financial instruments linked to, or referencing, any of these benchmarks.[13] Whilst global regulators & industry bodies are aiming to minimise value transfer in the transition process, this cannot be entirely eliminated and contracts linked to LIBOR are at risk of economic impact as they are transitioned to the new reference rates.

Preparing for transition

Given the use of LIBOR in relation to many financial products, any potential cessation of publication could have a financial and operational impact. It is important that market participants seek to understand how this may affect them. This may be achieved by taking some initial steps, including (though not necessarily limited to) –

- Identify which products they use that reference LIBOR;
- Identify what amount of exposure these products have to LIBOR, including which mature after the end of 2021;
- Examine and, if necessary, amend existing products to ensure there is robust language in place that sets out the steps to be taken, or the interest rate to be applied, in case LIBOR is no longer available (note the process for amending a particular financial product will depend on its terms and may require a consent process);
- Ensure appropriate documentation is in place to adequately disclose or mitigate risks associated with the discontinuation of LIBOR;
- For new products consider using RFRs and, if using LIBOR, again consider if there is robust language in place that sets out the steps to be taken, or the interest rate to be applied, in case LIBOR is no longer available;
- Produce an inventory of relevant systems used (e.g. trade booking, risk systems) that may be affected should LIBOR no longer be published in the future, and consider making changes that will allow those systems to use alternative rates.

Barclays is playing an active role in the reform agenda. We strongly encourage you to stay up-to-date on the latest developments and to consider how these changes may impact your organisation and the products in which you transact, using independent professional advisors (legal, accounting, financial, tax or other) as appropriate. You may want to consider raising questions of, and expressing views to, relevant industry bodies, trade associations and working groups, including responding to public consultations whenever possible.

You will find additional information (including about the potential risks of continuing with LIBOR) and useful links available through our website, https://home.barclays/libor-transition/ which we intend to update regularly.

The FCA also maintains a website[14] with useful materials on benchmark interest rate reform and LIBOR transition.

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[1] https://www.fsb.org/wp-content/uploads/r_140722.pdf

[2] https://www.fsb.org/wp-content/uploads/P141118-1.pdf The Bank Of England, UK Financial Conduct Authority, European Central Bank, European Commission, European Securities and Markets Authority, Federal Reserve Board, Federal Reserve Bank of New York, Commodity Futures Trading Commission, Swiss National Bank, Bank of Canada, Bank of Japan, Japanese Financial Services Agency, Hong Kong Monetary Authority, Monetary Authority of Singapore, and the Reserve Bank of Australia are some of the key institutions involved in benchmark interest rate reform.

[3] LIBOR is calculated for five currencies: British Pound Sterling, the Euro, Japanese Yen, Swiss Franc and the US Dollar. Panel banks submit rates for seven different tenors in each of these currencies, ranging from overnight to 12 months. Please see the administrator's website for more information: https://www.theice.com/iba/libor

[4] https://www.theice.com/publicdocs/ICE_LIBOR_Output_Statement.pdf

[5] https://www.bis.org/review/r190318f.htm

[6] https://www.fca.org.uk/news/speeches/the-future-of-libor The Bank of England expressed similar reservations from a prudential perspective: "The Committee agreed that market reliance on the Libor benchmark created a financial stability risk." https://www.bankofengland.co.uk/-/media/boe/files/record/2017/financial-policy-committee-meeting-march-2017.pdf

[7] The International Capital Market Association (ICMA), the Loan Market Association (LMA) the Association of Corporate Treasurers (ACT), the International Swaps and Derivatives Association (ISDA) and the clearing house LCH are some of the trade associations supporting benchmark reform efforts through membership in the working groups. Links to these organisations can be found in our FAQs.

[8] https://www.fca.org.uk/news/speeches/the-future-of-libor

[9] https://www.federalreserve.gov/newsevents/speech/quarles20190603a.htm

[10] https://www.fsb.org/wp-content/uploads/P141118-1.pdf The Financial Stability Board updated market participants on the latest developments in late 2018. Another report is expected in late 2019

[11] https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/shared/pdf/20190227/2019-02-27_WG_on_euro_RFR_meeting_Minutes.pdf

[12] https://www.emmi-benchmarks.eu/assets/files/D0251A-2019%20-%20PR%20Benchmark%20Statement_Final.pdf The EURIBOR administrator, the European Money Markets Institute (EMMI), anticipates reforms will complete by Q4 2019

[13] https://www.bis.org/publ/qtrpdf/r_qt1903e.pdf The Bank of International Settlements provides a more detailed assessment of the transition landscape.

[14] https://www.fca.org.uk/markets/libor