IBOR Transition
– an Introduction

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Telephone calls may be recorded.

BMO Global Asset Management provides clients with an overview ahead of changes taking place on or before 31 December 2021 to Interest Rate Benchmarks.

Background

Interbank Offered Rates (IBORs) have been an important component of global finance for over 40 years, being used to reference trillions of pounds of bonds, loans, derivatives and deposits, as well as being used as a performance benchmark for investments and portfolios.

However, during the global financial crisis, observed limitations to IBORs as measures of risk led regulators around the world to launch the benchmarks reform initiative. This included strengthening the IBOR rate setting process by tying its calculation to actual transactions as well as the development of alternative risk-free rates (RFRs).

Following on from the global reform initiative, the United Kingdom's Financial Conduct Authority (FCA) announced in July 2017 that at the end of 2021 it would no longer supervise the London Interbank Offered Rate (LIBOR) in December 2021. In parallel with the cessation of LIBOR, the Euro Overnight Index Average (EONIA) will stop being published at the end of 2021.

Other key reference rates, such as Euro Interbank Offered Rate (EURIBOR) and Canadian Dollar Offered Rate (CDOR), will continue to operate, at least for a few years, after the end of 2021. In many instances, we are likely to see legacy IBORs operating alongside the new RFRs.

LIBOR

The FCA, LIBOR's regulator, has stated that after 2021 it will not compel contributing banks to submit quotes for the daily calculation of LIBOR.

Global regulators have stressed that market participants should assume that LIBOR will terminate at the end of 2021 and, therefore, begin transitioning away from LIBOR and onto alternative rates.

As LIBOR has five currencies, the transition to RFRs for each of those currencies will pass supervision away from a single authority, the FCA, to national supervisors in each currency jurisdiction. While Sterling Overnight Index Average (SONIA), as the replacement for sterling LIBOR, will remain within scope for the FCA, regulators in each of the US, eurozone, Switzerland and Japan will have responsibility for the oversight of their respective RFRs.

EONIA

The European Central Bank and the European Money Markets Institute (EMMI), EONIA's regulator, has confirmed that EONIA's last publication date will be 3 January 2022.

Related to these reference-rate reforms, the EU Benchmark Regulation (EU BMR) became effective on 1 January 2018. Its purpose is to increase the strength and reliability of financial benchmarks. The regulation's transition period extends to the end of 2021. According to the European Central Bank (ECB), "EONIA in its current form will not become EU BMR compliant, given the lack of underlying transactions and high concentration of volumes by only a few contributors."

The ECB Working Group on Euro Risk-Free rates was set-up to identify alternative risk-free rates for the eurozone. The Working Group selected €STR (Euro Short Term Rate) as the alternative rate for the eurozone. €STR started being published on 2 October 2019.

How BMO Global Asset Management is addressing the end of LIBOR and EONIA

The IBOR cessation involves a transition from a well-established regime of reference rates to alternative risk-free rates, that will vary by market. Unlike regulatory changes with defined rules, the IBOR Transition is focused on replacement options for the current market rates.

BMO Global Asset Management have led in executing the transition from sterling LIBOR to its RFR, SONIA, as recognised by www.risk.net.

In collaboration with colleagues across BMO Financial Group, we set up an active change programme in 2019 with an ongoing emphasis on continuing to fully support our clients, minimising risk and, where possible, maximising opportunities to transition to alternative investments of similar profile.

As new developments arise, we will post updates on our website.

If you have any questions regarding the transition, please do get in touch.

FAQs

The following frequently asked questions cover many of the outstanding issues identified by market participants. This document will be updated from time-to-time to reflect industry and market results.

Q: What are IBORs and LIBOR?

LIBOR stands for London Interbank Offered Rate and IBOR stands for Interbank Offered Rate. An interbank offered rate is the average rate at which certain banks can borrow and lend to one another in the interbank market. Both LIBOR and IBORs indicate the cost of lending funds to market participants and are used as a reference rate or benchmark. Examples of IBORs include CDOR (in Canada), HIBOR (in Hong Kong), EURIBOR (European Union), TIBOR (in Japan) and LIBOR (several jurisdictions). LIBOR is the most widely-used and well-known interest rate benchmark and, like other IBORs, is calculated based on submissions from individual panel banks on the rate at which they will lend to other market participants. LIBOR is published in British pound sterling (GBP), US dollar (USD), euro (EUR), Swiss franc (CHF) and Japanese yen (JPY).

LIBOR is also published in several tenors: overnight, one week, one month, two month, three month, six month and twelve month. Three-month LIBOR is the most widely quoted and transacted.

Q: Why and when is the use of LIBOR stopping?

There are four inter-connected reasons:

1. Regulatory changes

Due to several significant market volatility events over the last 10 years, regulators made changes to the way in which banks fund their cost of lending. Banks are no longer able to fund on an unsecured short-term basis. They are now required to fund on a longer-term basis. This caused the number of actual transactions underlying LIBOR, which is predominantly a short-term funding mechanism, to decline. This subsequently led to an increased reliance on a small number of panel bank submissions.

2. Robustness as a benchmark

A benchmark must be robust. Given that the transactions underlying LIBOR have decreased, IOSCO (International Organization of Securities Commissions), a global regulatory body that determines what can be a benchmark, believes that the quality of LIBOR has deteriorated to the extent that its viability as a standard reference rate for all financial instruments has become questionable.

3. Reliability concerns

Reliance on panel bank submissions led to concerns about the reliability of the rate in what have been badged "LIBOR rigging" scandals. A benchmark this important should not be or perceived to be easily manipulated.

4. Cessation of support from Regulatory Authorities

A significant event for LIBOR occurred in July 2017 when Andrew Bailey, the former Chief Executive Officer of the UK's Financial Conduct Authority (FCA) and the current Governor of the Bank of England, announced that the FCA would no longer compel panel banks to submit the rates required to calculate LIBOR beyond the end of 2021. Other global regulators remain united and consistent, if not more urgent, in this messaging.

Q: What are the alternatives to LIBOR?

Industry working groups across the globe have conducted extensive analysis to identify, adopt and publish alternative risk-free rates (RFRs) to replace IBORs. The IBOR transition is at different stages of progress in the different jurisdictions. Below is a table of known alternative rates by jurisdiction:

Known alternative rates by jurisdiction

Jurisdiction	Legacy Benchmark	RFR	Secured or Unsecured	Underlying Asset	Rate Administrator	Publication Date
United States	USD LIBOR	SOFR – Secured Overnight Financing Rate	Secured	Repos	Federal Reserve Bank of New York	03-Apr-18
United Kingdom	GBP LIBOR	SONIA – Sterling Overnight Index Average	Unsecured	Money Markets	Bank of England	"Reformed: 23-Apr-2018 (Original Pub.: April 2016)"
Eurozone	"EONIA, EUR LIBOR"	€STR (ESTR) – Euro Short-Term Rate	Unsecured	Money Markets	European Central Bank	02-Oct-19
Switzerland	CHF LIBOR	SARON – Swiss Average Rate Overnight	Secured	Repos	Six Swiss Exchange Ltd	25-Aug-09
Japan	JPY LIBOR	TONAR – Tokyo Overnight Average Rate	Unsecured	Money Markets	Bank of Japan	Late 2016

Source: BMO Global Asset Management, Jul-20.

Q: What industry working groups have been established?

The below represents a select number of working groups that have been established globally to address IBOR transition issues.

1. Working Group on Sterling Risk-Free Reference Rates

The overall objective of the Working Group is to accelerate a broad-based transition to SONIA by end-2021 across sterling bond, loan and derivative markets, in order to reduce the financial stability risks arising from widespread reliance on LIBOR. The Working Group recommended the Sterling Overnight Indexed Average (SONIA) as the preferred sterling risk-free rate as it has the capability to evolve over time, tends to be predictable, and tracks bank rates closely. SONIA is already referenced in the sterling Overnight Index Swap (OIS) market, making the transition easier. It measures the rate charged by banks on lending funds overnight and is calculated based on actual rates paid on borrowing overnight unsecured wholesale funds.

2. Alternative Reference Rate Committee (ARRC)

The ARRC was convened by the Federal Reserve to identify alternative reference rates to replace USD LIBOR and recommended the Secured Overnight Financing Rate (SOFR) as its preferred alternative rate. SOFR is an overnight, secured referenced rate administered by the Federal Reserve Bank of New York that broadly measures the cost of overnight borrowing with U.S. Treasuries provided as collateral. It is firmly based on transaction data and is calculated as a volume-weighted median of tri-party repo transactions. The ARRC selected SOFR as the alternative reference rate due to it 1) being IOSCO compliant, 2) being transaction based, 3) relying on the robust daily volume in the repo market, and 4) being an overnight rate.

3. Euro Working Group

The European Central Bank (ECB), the Belgian Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA) and the European Commission launched a private sector working group on euro risk-free rates. The working group was tasked with identifying an alternative RFR to serve as a basis for an alternative to the current benchmarks used in a variety of financial instruments and contracts in the euro area. The working group recommended €STR as its preferred nearly risk-free rate for the euro area.

4. National Working Group on Swiss Franc Reference Rates (NWG)

The NWG on CHF Reference Rates is the key forum for considering proposals to reform reference interest rates in Switzerland. The working group selected SARON, which is an overnight reference rate of the secured funding market for Swiss franc and is based on transactions and quotes posted in the Swiss repo market.

5. Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks

This committee was established in August 2018 as the key forum for considering proposals to reform reference rates in Japan and choose replacement Japanese yen interest rate benchmarks. The Committee selected the uncollateralized overnight call rate, called Tokyo Overnight Average Rate (TONAR). It is published and calculated by the Bank of Japan and is transaction-based using information provided by money market brokers.

Q: What industry work has been done to help in the transition away from LIBOR?

Firms are preparing and executing their transition plans and will likely continue to do so into 2022. Industry working groups in each jurisdiction have provided recommendations and publications to assist with the transition to RFRs. Key work remaining includes:

- Drafting and implementing language in existing contracts that deals with the discontinuation of LIBOR
- Development of new RFR-linked products
- Developing methodology on how to build forward-looking term rates
- Transition planning for migration of products from IBORs to RFRs
- Updating existing financial market and individual market participant infrastructure to accommodate the transition to RFRs

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