Momenta

LIBOR Transition

What is LIBOR and why is it necessary?

All players in financial services are facing the biggest change since the implementation of the Euro, as firms transition away from London Inter-Bank Offered Rate (LIBOR). In 2017 Andrew Bailey, the then Chief Executive of the FCA stated that they would no longer be asking Panel Banks to submit the once global benchmark standard interest rate- LIBOR after 2021, as the rate proved to be an unreliable benchmark for international interest rates.

$350 trillion worth of financial contracts are currently treated under the LIBOR rate highlighting the sheer volume of debts whose index rates should be switched. On the 16th of January 2020, the FCA and the PRA issued letters to banks and insurers, explaining their expectations of institutions' transitional planning for 2020 highlighting the need to act now rather than later. One of the biggest challenges will be that of re-papering and fallback language. The new RPR's will be calculated differently to LIBOR so contracts created under the new rates will differ from those under LIBOR rates.

How it will affect your organisation?

SONIA replacement LIBOR: The overnight rate in GBP is SONIA, an overnight rate borrowing and lending cash for 24 hours. There are no term rates as with LIBOR. LIBOR is usually greater than SONIA, this is because LIBOR includes an element of risk of institutional failure that is not present in SONIA. Therefore, the replacement of LIBOR with SONIA must be accompanied by compensation in the form of cash or a change in the terms of the transaction that reflects the equivalent value, for example, the margin on a loan (Extra Spread).

Legal risks and issues: At the time of entering into long-term LIBOR-indexed contracts, certainly before 2013, it is rather unlikely that parties will have contemplated that the reference index would cease to be published during the life of the contract. For all financial products such as bonds, IRSs, FRNs, and such alike, the replacement of LIBOR with a different index (SONIA) will change the value of the transaction should the replacement index be simply substituted. Should this happen, one party will gain and the other will lose as the result of a change.

Value transfers: Internal valuation models will need to be adjusted for replacement RFRs. IBORs will need to be identified and will need to be transitioned. The transition to an overnight RFR will lead to changes in the value of existing positions, which could be favorable to counterparties, meaning additional negotiation will be needed.

Hedging Risk Management issues: For hedge accounting to be valid, the risk and the hedge must match. If there is a change to the variable rate in the hedge (such as a swap) without an appropriate change in the product being hedged (a loan for example) then a basis risk arises. There is a risk that hedging strategies start to have different reference rates and exposures will not perfectly net. Firms are required to carefully plan their transitions from the IBOR to manage this basis risk.

Regulatory Pressure: Regulators feel that the pace in which it is occurring is not fast enough. On the 16th of January 2020, the FCA and the PRA issued letters to banks and insurers, explaining their expectations of institutions' transitional planning for 2020. This year has been deemed as the year “for LIBOR transition” and regulators expect to see evidence of the transition plans from Q1.

Updating customers/clients whose contracts are tied to LIBOR: Banks and firms will need to ensure that any changes made to any LIBOR indexed product, that all their customers and players associated with any LIBOR indexed product, will need to be engaged. All customers will need to understand any change that occurs and if not done so in the appropriate manner, banks and firms could see several serious legal implications because of misinforming, updating and discussing the transition with their customers.

Helping you through the transition

Momenta are a global contingent resource solutions firm. For over 30 years we have been partnering with companies in the financial services, legal, technology and training and development sectors to cost effectively provide the right people, with the right skills, at exactly the right time.

Given the mammoth task ahead, Momenta are partnered with one of the leading experts acting and advising on issues associated with the LIBOR Transition and have built teams to support in all aspects of the transition from:

- Identifying the contracts that need to be swapped
- Re-paper according to an appropriate index rate
- Reviewing fallback language
- Calculating the fluctuated pricing with each contact as a result of the new IBOR attached to any calculation or swap
- Communication to the end customer regarding their new rate

This provides a holistic solution from start to end avoiding any time wastage helping you transition your contracts to a new index in time, efficiently and effectively.

The next steps in your transition

Momenta will be glad to discuss your transitional plans and would welcome a call to discuss how we can assist. To set up a discussion email libor@momentagroup.com and our team will contact you.