The Working Group on
Sterling Risk-Free Reference Rates

FAO: Loan System Providers & Treasury Management System Vendors ("vendors")

17 December 2020

Supporting markets to cease the issuance of LIBOR linked loan products

I am writing to you on behalf of the market-led Working Group on Sterling Risk-Free Reference Rates ("RFRWG")[1] to request your support in delivering one of the RFRWG's top-level priorities. As you will be aware ICE Benchmark Administration, the administrator of Libor, has recently announced it is consulting on its intention to cease publication of Libor. The need to move away from Libor has been apparent for some time and the RFRWG has recommended a number of public milestones to facilitate a smooth transition in sterling markets. Most notably, by end-Q1 2021, we are asking lenders and borrowers to take the necessary steps to cease issuance of all GBP LIBOR-linked lending expiring beyond the end of 2021.[2] There has been significant progress in the development of lending conventions and the RFRWG considers **it to be crucial that development of suitable software packages are finalised and released as soon as possible so that lenders and borrowers can take the necessary steps to implement their system updates ahead of the end Q1 2021 target.**

Based on positive engagement at the January 2019 workshop held for loan systems providers and the January 2020 workshop held for Treasury Management System (TMS) providers, we would expect that vendors are now in the final stages of delivering any remaining software changes. Vendor readiness is critical if market participants are to meet the timeline recommended by the RFRWG and be prepared for Libor to cease being available. In particular, the market is looking for solutions that support SONIA compounded in arears and Annex I. lists some of the key characteristics to consider including in your products.

Based on the aggregated summary of the results of the TMS provider survey (see Annex II.) and UK Finance's feedback to the RFRWG on the results of a similar survey that it has undertaken of banks and lenders, there is positive evidence that good progress is being made on industry awareness and vendor readiness in advance of the Q1 2021 milestone. UK Finance has told the RFRWG that, although the responses to its survey acknowledge the great deal of work that has already been undertaken by many vendors, the responses also highlight that the sequencing of software changes continues to be a critical concern for many lenders. There is a material reliance on timely delivery from vendors. UK Finance has also said that the majority of banks and lenders who responded to its survey are reliant on the readiness of TMS providers and that, while there was recognition that engagement between all parties was extensive and ongoing, this is now at a crucial stage.

[1] Initiated by the Bank of England in 2015, the RFRWG's membership is drawn from a diverse set of market participants, including: banks/broker dealers; asset management firms, pension funds and insurance companies; corporates and other issuers; infrastructure firms; and trade associations representing relevant sectors and markets. The Bank of England and the Financial Conduct Authority (the FCA) are each ex-officio members of the RFRWG. The views and considerations in this letter and the annexes thereto do not constitute guidance or legal advice from the Bank of England (including the Prudential Regulation Authority (the PRA)) or the FCA nor are they necessarily endorsed by the Bank of England (including the PRA) or the FCA.

[2] RFRWG roadmap and priorities: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfr-working-group-roadmap.pdf

In conclusion, the RFRWG calls for action from all loan vendors and TMS providers to support their clients and the market in the transition away from Libor through ensuring software is able to accommodate the RFRWG's loan market convention recommendations ahead of end Q1 2021.[3]

Sincerely,

Tushar Morzaria

Chair of the Working Group on Sterling Risk-Free Rates

[3] Detailed convention documentation (including precise mathematical formula, sequencing of steps and rounding points): https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/statement-on-behalf-of-rfrwg-recommendations-for-sonia-loan-market-conventions.pdf

Annex I.

Some key features to be considered for delivery for each product

Loan Product solutions

- Compounded Interest calculated in Arrears via Rate compounding
- Interest calculated daily and compounded daily based upon number of calendar days within an interest period
- Compounding occurs every day that SONIA rates are published
- The market convention uses a 5 business day look-back (lag) without any observation shift adjustment
- The market convention for the maths supporting the compounding calculation is the Non-cumulative Compounded Rate ("NCCR") approach
- Adoption and application of NCCR enables Loan Agents and Lenders to calculate and apportion interest on a daily basis across all holders of debt in an interest period. This is a core requirement for all loans
- Systems to calculate and identify all components of a borrowers "All in Rate" interest liability i.e. SONIA Compounded, Credit Adjustment Spread and Margin

TMS Vendor solutions[4]

- The ability to book derivatives and cash instruments linked to RFR, such as Interest Rate & Cross Currency Swaps, Loans and Deposits and Floating Rate Bonds
- Deal Capture to support fixing overnight rates using simple and daily compound averages with specific characteristics such as lookback days, lockout periods and payment delays
- Back Office systems to have capabilities to fix rates, calculate interest accruals, settlements and confirmations for RFR instruments based on compounded and simple averaging conventions
- Accounting Systems to be updated for RFR instruments, with the ability to post interest accruals, valuations and settlements
- Hedge Accounting under IAS39 & IFRS9 and other Financial Reporting disclosures to be updated with new RFR
- Risk Management capabilities for RFR in Zero Coupon Curve Construction, Discounting, Value at Risk Models and Valuation of Derivatives especially for Interest Rate and Cross Currency Swaps
- In House Bank capabilities to use RFR for Internal Bank Accounts
- Cash Management forecast to include RFR cash flows
- Regulatory Reporting impacts of RFR instruments for EMIR/Dodd Frank/MAS Reporting and Portfolio Reconciliations
- RFR Calculator based on both compounded and simple averaging
- Automation to move existing Loans, FRN's and Swaps to the appropriate Fallbacks (after end-2021)

[4] TMS workshop slides: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/workshop-for-treasury-management-system-presentation.pdf

Annex II.

Treasury Technology Providers Readiness Survey results compiled by the Technical Sub-Group for Infrastructure Related Issues ("Infrastructure Sub-Group") November 2020

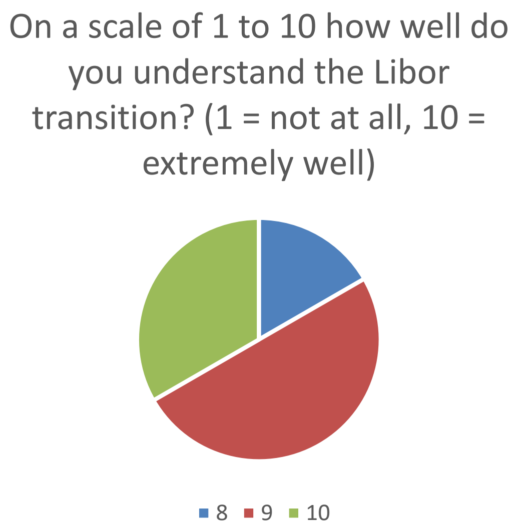
The survey was sent to 15 Treasury Management System vendors on the 21st October and was compiled from the 6 responses received by the 5th November.

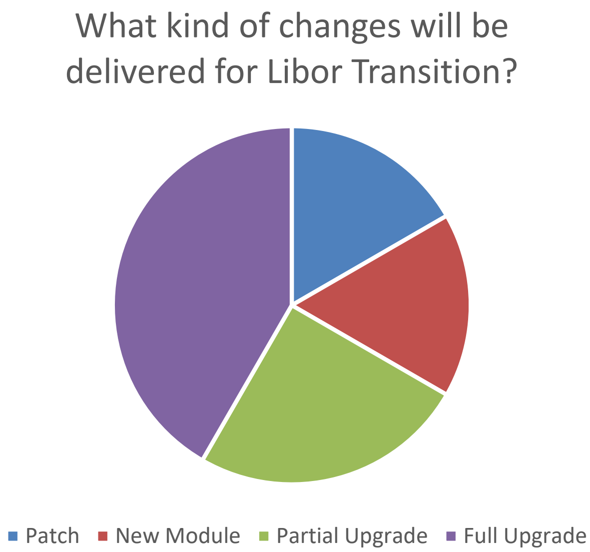
All respondents answered that:

- They are being informed on the latest developments from industry bodies and the risk-free rate working groups. Some would like further information/clarification and there was one suggestion to form a central library for educational materials
- They would like to have further meetings with the Infrastructure Sub-Group to discuss the Libor transition
- Covid-19 has not materially slowed down their implementation and roll out plans
- They have a release strategy in place for Libor Transition with timelines and system changes
- They have taken delivery of system enhancement/coding and are testing these
- They will be able to support compounded in arrears methodology with both Observation Shift and Observation Lag approach. The majority already have this available, and it is work in progress for the remainder.
- There was an increase in client's interest around Libor transition post Q3 2020

Most respondents answered that:

- They will deploy the required system changes in the next 3 months
- They anticipate that clients will take 3-6 months to integrate system updates after system release (answers ranged from less than 3 months to 12 months)
- They have the ability to support non-Libor linked lending, and provision for inclusion of pre-agreed conversion mechanisms ahead of end 2021 into contractual language for new and re-financed Libor lending. The remainder confirmed that that this was work is in progress.
- They were planning to support use of the SONIA compounded index published by the Bank of England
- Their clients were requesting more information on the Libor transition
- They have a timeline for communicating details on anticipated changes including implementation timelines and testing strategy
- As part of their client engagement, they were holding regular forums on Libor transition





Selection of responses to other questions:

What additional help would you like to see from industry groups?

- Provide sample deals with all the detailed calculations for the different methodologies
- Clearer directions for fallback language on existing transactions (in addition to ISDA fallback)
- Market insights and general trends being seen from corporates and Financial institutions (e.g. convention details)
- Application of the new guidance from IASB and FASB

If applicable, what are your "obstacles" to product development?

- Clear specifications and market readiness for volatility products

Are there any changes to the format of RFR benchmark publications that would/could support system integration (i.e. ability to obtain the data using SFTP, choice of file formats (csv, xls, etc.))?

- Ability to access rates, to send calculation parameters and return compounded rate via API

Will you be providing any tools to support hedge accounting for the transition of existing LIBOR based hedges to RFR?

Responses ranged from those already catering for hedge accounting to those where this is not even on the next phase of their development work. Some of these functionalities included impact assessment and risk management.

What else could be done by the various risk free rate working groups, trade associations or industry bodies to drive global consistency?

- Efforts should be made to outline plans as early as possible as technical implementations can take time
- Alignment in terms of methodologies and rounding options (e.g. harmonisation of market convention between cash and derivatives, and consistency across currencies)
- Consistency around messaging in relation to possible future term structure for RFR and clarity about the usage of term rates for derivatives (linear and non-linear)
- Clarification on terms of bilateral trade fallback mechanism (e.g. clearer calculation)