IBOR transition: Corporate Clients FAQ

What is happening?

The G20 asked the Financial Stability Board (FSB) in 2013 to review and recommend reforming major interest rate benchmarks. In 2014 the FSB published its recommendations, which were composed of two pillars:

i. reforming LIBOR (and equivalents) to ensure they are as reflective of underlying market conditions and anchored in transactions as far as possible; and
ii. developing alternative near risk free rates for use where neither term nor bank credit properties are required.

The banks who currently contribute to the calculation of LIBORs will no longer be compelled to submit rates beyond the end of 2021.

Global regulators have played an active role in fostering the transition away from IBORs and the financial services industry world-wide is now deep into the process of developing new products using Risk Free Rates ("RFRs") that will be used to price loans, mortgages, bonds, derivatives and other financial instruments in future.

For more information on these rates and the differences between them, please see further below.

What are Risk Free Rates?

There is a range of overnight near-risk-free rates that have been selected for the 5 LIBOR currencies. The list can be viewed here.

The new risk-free rates (RFRs) provide for robust and credible overnight reference rates, well suited for many purposes and market needs.

Both cash and derivatives markets are expected to transition to utilise RFRs as primary benchmarks.

Where is it happening?

Changes are taking place in all major economies including Germany, the US, the UK and Asia.

For more details on the changes taking place in individual countries please visit the Resources section.

How many benchmarks are involved?

All countries with their own currencies have their own benchmarks that are used for financial products in those currencies.

Many financial products around the world reference one of the five London Interbank Offered Rate (LIBOR) benchmarks: in addition to Sterling LIBOR, there are US Dollar, Japanese Yen, Euro and Swiss Franc LIBORs.

In the European Union, for example, there are three impacted benchmarks: the Euro Overnight Index Average (EONIA), EUR LIBOR, and the Europe Interbank Offered Rate (EURIBOR). It is important to note that EURIBOR is expected to continue to be available for use beyond the end of 2021 after being reformed in September 2019 to be compliant with the EU Benchmark Regulation.

In the US, products are either linked to US dollar LIBOR or the Effective Federal Funds Rate (EFFR). USD LIBOR is in scope for change as part of this process.

Reforms are taking place in many other countries including Switzerland, Hong Kong, Canada, Singapore, China, Indonesia, Thailand, India, Philippines and Australia.

Are all benchmarks changing?
The focus of this change is on the five main LIBORs (GBP, USD, EUR, JPY and CHF) that are expected to discontinue along with EONIA which will no longer be compliant for use per EU Benchmark Regulation beyond the end of 2021.

EURIBOR has already been subject to in-depth reforms over the last few years in order to meet the EU Benchmarks Regulation requirements, strengthening its governance framework and developing a new hybrid methodology.

However, many regulators are looking to either replace benchmarks in the years ahead or to move to a multi-rate system where the existing benchmark and the new benchmark can be used, particularly in Asian markets.

*For an explanation of these benchmarks please see the glossary.

Why are benchmarks changing?
Financial regulators want to improve the safety, transparency and accuracy of benchmarks.

The unsecured inter-bank lending market that LIBOR is based upon just doesn't exist as it once used to with fewer underlying transactions than ever, especially in certain tenors and currencies. Unlike IBORs, Risk Free Rates are based on observable transactions which provide a robust basis for their calculation.

Who does this impact?
The transition will affect anyone that owns a financial product linked to an IBOR benchmark or to EONIA.

What products use IBOR benchmarks?
IBORs are a cornerstone of the financial industry today, and the transition away from them impacts a vast array of financial products including derivatives, bonds, loans, and transaction banking products.

How do I know which benchmark my product uses?
Details of the benchmark referenced and any relevant interest calculation will be detailed in your product documentation or trade confirmation. For more information please get in touch with your Deutsche Bank Sales contact.

When is transition happening?
It is expected that the five major LIBORs and EONIA will be discontinued after the end of 2021 The transition to the new RFRs should be completed in advance of that date. Plans should also include updating fallbacks on LIBOR referencing contracts prior to the end of 2021.

The Transition Process

What do I need to do?
The path to transition away from LIBOR is complex. Market participants need to understand clearly the differences between LIBOR and alternative rates as part of transition discussions

1: Identify which products you use that reference LIBOR; the amount of exposure you may have.

2: If any of your products mature post the end of 2021, review your documentation.

3: Speak with your Deutsche Bank Sales contact to discuss if the products you use are affected and ask questions if you are unsure. If you need more detailed information about risk free rates, your Deutsche Bank contact will be able to help.

4: If you do have a product which is linked to a benchmark that is expected to be discontinued, we can explain the choices available to you.

5: If your documentation has an appropriate fallback clause in it, you may decide not to do anything. Alternatively, your documentation may need to be amended to ensure that the discontinuation of the benchmark rate is taken into consideration. Some complex products may require additional steps. For more information on fallback clauses see below.

6: Please contact us as soon as possible to discuss the options available and to enable us to work with you to complete the process in good time.

7: Produce an inventory of relevant systems and infrastructure used 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.

What is a fallback clause?
Fallbacks are the legal provisions in a contract that apply when an external event or 'trigger' occurs and define the steps that should be taken to agree a new reference rate if the reference rate in the transaction is no longer available.

In the context of benchmark reform, fallbacks could be triggered when LIBOR is no longer published, or when the FCA announces that LIBOR is no longer representative of the underlying market.

Historically, fallbacks in some financial contracts have been designed to deal with the temporary unavailability of a benchmark, not the permanent cessation of a benchmark. Fallbacks in some products may work, but produce results that you may find uncommercial.

Ideally fallbacks should be amended to be effective and robust for the expected discontinuation of LIBOR and EONIA.

How do I know if my product is based on a contract with a fallback clause in it?
We recommend speaking to your Sales contact, who is ready to help, as well as reviewing your product documentation.

What happens to products that are not transitioned to alternative rates by the deadline?
This will depend on the fallback in the contract and therefore all market participants are strongly encouraged to pursue active transition or to amend documentation accordingly.

How could the transition impact the terms of the contract, for example the return I receive on an investment product or the interest rate I pay on a loan?
The transition from LIBOR to alternative rates could impact investment returns and the cost of borrowing. Please discuss with your Deutsche Bank sales contact in the first instance.

Products

Cash Products

I have a LIBOR referencing loan with Deutsche Bank. What should I do?
RFRs are overnight indices which do not have a term structure unlike LIBOR, which does e.g., 1month, 3month, 6 month tenors. LIBORs are forward looking (rate fixing in advance and payment in arrears), whereas risk free rates are backward looking (rate fixing in arrears and payment in arrears). This means that, using RFRs, you will not know how much interest to pay or receive on a loan until the end of each interest coupon period.

Similarly, products such as cash accounts, overdrafts or trade finance facilities that currently reference benchmarks that are being discontinued will be amended so they are linked to alternative reference rates.

Please speak to your Deutsche Bank sales contact to discuss how this will work for your products and the practical steps that need to be taken.

Derivatives

I have derivative contracts with Deutsche Bank. What should I do?
Please speak to your Deutsche Bank sales contact to discuss how this will work for your products and the practical steps that need to be taken.

What type of derivatives are impacted?
Benchmarks are used in all linear and non-linear OTC interest rate derivatives. They are also used in some credit and FX derivative products.

What will change and when?

This varies from country to country notwithstanding the expected cessation of LIBOR after the end of 2021 for all products.

In the UK for example, market participants are required to significantly reduce their inventory of LIBOR linked products by the end of Q1 2021.

Existing derivatives contracts that mature beyond the end of 2021 should be proactively transitioned, and as a risk management measure, fallbacks updated to apply the ISDA IBOR Fallback Protocol that is now available.

How will the process of changing existing contracts work?
Banks and their clients will need to agree the basis on which the change will take place. In some cases, the contracts for existing trades contain an agreed approach to cover the eventuality that a benchmark ceases to be published, known as fallback provisions. These are typically not robust so need to be updated, preferably by adopting the ISDA IBOR Fallbacks Protocol.

Regulators have stated that fallbacks should not be relied upon as the primary conversion mechanism for legacy trades and market participants should wherever possible proactively transition from legacy benchmarks to alternative Risk Free Rates.

What are fallback provisions?
Fallbacks are the legal provisions in a contract that apply when an external event or 'trigger' occurs and define the steps that should be taken to agree a new reference rate if the reference rate in the transaction is no longer available.

In the context of benchmark reform, fallbacks could be triggered when LIBOR is no longer published, or when the FCA announces that LIBOR is no longer representative of the underlying market.

Historically, fallbacks in some financial contracts have been designed to deal with the temporary unavailability of a benchmark, not the permanent cessation of a benchmark. Fallbacks in some products may work, but produce results that you may find uncommercial.

Ideally fallbacks should be amended to be effective and robust for the expected discontinuation of LIBOR and EONIA.

What is the plan to update fallback language?
The majority of derivatives are traded under a standard master agreement provided by the International Swaps and Derivatives Association (ISDA), an industry body that focuses on derivatives. The fallback language in ISDA master agreements is currently inadequate with regard to permanent index cessation and therefore ISDA has produced the ISDA IBOR Fallbacks Supplement and Protocol. The Protocol serves to update fallbacks in any transactions that have already been undertaken or are effected before 25 January 2021 between any two adhering parties. After this date, all ISDA master agreements will adopt the new fallbacks (the Supplement) for new transactions with no action required by market participants. Deutsche Bank has adhered to the protocol to cover its legacy portfolio and has written to its clients to ask them to do the same.

In addition to the forthcoming IBOR cessation, Deutsche Bank is subject to the European Benchmarks Regulation (EU-BMR) which requires all transactions in derivatives referencing any benchmarks to be covered by robust fallbacks. In 2018, ISDA released the Benchmarks Supplement Protocol which provides a robust but generic waterfall of steps for counterparties to agree alternative rates in the event of a benchmark materially changing or ceasing to exist. Deutsche Banks has adhered to this protocol and has applied it to both its new and legacy transactions with clients. For this protocol to apply, both counterparties must bilaterally elect against each other. Deutsche Bank has requested that its clients apply this protocol to both new and legacy transactions in the same communication as that for the IBOR Fallbacks Protocol.

For other, non-ISDA master agreements such as those provided by the German and French Banking Associations amendment language exists already that is complaint with EU-BMR. Additional fallback language to mirror the ISDA Fallbacks Protocol is expected but this is not yet available. It is Deutsche Bank's intention to ask clients to enter into the upgraded fallbacks as soon as they are released.

Where can I find further information relating to the ISDA protocols?
ISDA's website is a source of much detailed information.

- Benchmark Reform and the transition from LIBOR
- ISDA Fallbacks Protocol
- ISDA Benchmarks Supplement & ISDA Benchmarks Supplement FAQs
- ISDA Benchmarks Supplement Protocol & Protocol FAQs-
- ISDA Benchmarks Supplement How to Adhere: Step-by-Step instructions