



IBOR – Replacement by new reference rates

The introduction of alternative reference values (RFRs)

The aim of the change and which requirements are there?

IBOR describes the common "interbank interest rate" and plays a central role in the international financial markets. It refers to the weighted asking interest rate at which banks grant each other short-term loans and is determined by a bank panel. Since it serves as the basis for many financial products in its various forms, it is relevant for almost all financial market players and their divisions.

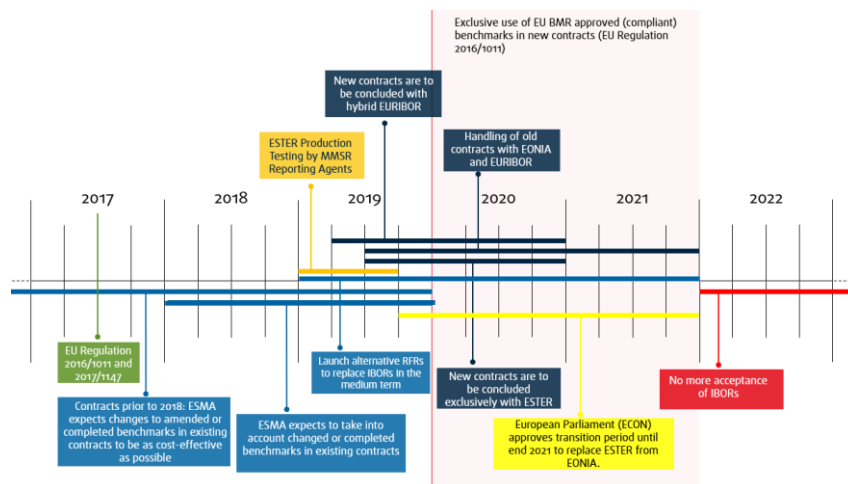
In the recent past trader led manipulation of the LIBOR revealed the vulnerability of private sector investigations of the IBORS. The sharp decline in transaction volumes associated with the loss of confidence led to the recommendation of the Financial Stability Board to replace this practice in the various currency areas with a transaction-based, and thus less manipulable, reference rate method. Deployed working groups have defined methods for the respective currency area for the tamper-proof determination of risk-free rates.

Currency	IBOR	RFR	Working Group	State
GBP	GBP LIBOR	Sterling Overnight Index Average (SONIA)	Working Group Sterling Risk-Free Reference Rates	SONIA was released in April 2018. The working group meets again in February 2019 and expects if necessary, further influences due to the EU MMF reform and Brexit.
USD	USD LIBOR	Secured Overnight Financing Rate (SOFR)	Alternative Reference Rates Committee (ARRC)	SOFR was published in 2018 and four major banks have already converted their products to this interest rate in August.
EUR	EURIBOR	Hybrid EURIBOR	European Money Market Institute (EMMI)	EMMI publishes 2nd consultation paper and gets feedback from market participants on new "hybrid" calculation methodology. FSMA will test in 2019 if this methodology complies with the benchmark regulation.
EUR	EONIA	Euro Short Term Rate (ESTER)	ECB, FSMA, ESMA + European Commission form working group	Working Group agrees on new risk-free, unsecured reference rate, ESTER, to be deployed in Oct. 2019. However, it is not designed for longer-term maturities.
CHF	CHF LIBOR	Swiss Average Rate Overnight (SARON)	National Working Group on Swiss Franc Reference Rates	The conversion to SARON has already been completed by the end of 2017. Five market participants have approved the Active Quoting.
JPY	JPY TIBOR/LIBOR	Tokyo Overnight Average Rate (TONA)	Study Group on Risk-Free Reference Rates	Working group agrees on TONA as RFR.

In addition to the methods, the working groups have already set the timelines for the replacement of the old IBORs. This increases the pressure to act, especially for those financial market players for whom multi-currency RFRs are relevant. Against this background, these must be analyzed and adapted in affected contracts, products and processes.

As a result, the expected challenges are to be outlined using the example of the new hybrid EURIBOR. For the euro area, benchmarks from 2020 onwards must be determined precisely and with integrity, in line with the 2016 Benchmark Regulation (2016/2011). According to the current understanding, in addition to a transaction-based determination based on market data, a comprehensible estimate also fulfils this requirement. The EMMI, as the responsible working group, has defined the parameters for determining the hybrid EURIBOR in three levels.

In addition to using transaction data from the Money Market Statistical Reporting MMSR (Level 1), the EMMI has transactional data from near-money market transactions between financial institutions, e.g. Floating Rate Notes from other data sources (Level 2). Level 3 also allows an estimate of the refinancing costs of the panel banks involved in the case of non-representational depiction. However, the test phase has yielded a disproportionate share of estimates (between 57% and 83%)¹, which makes a FSMA approval questionable as benchmark-compliant. Alternatively, the use of the ESTER as a basis for EURIBOR-equivalent forward interest rates is considered as a fallback scenario. In June 2018, the ECB published the methodology for the EONIA successor, ESTER. ESTER is to be introduced according to the current state in October 2019, but with a two-year transitional period until the end of 2021. This is then determined on a TARGET2 basis based on the transaction volumes of the 52 largest banks transmitted as part of the money market statistics report. Currently a test phase is running.



Challenges for European Financial Institutions

The process chains of different products based on the different RFRs are affected front-to-back by the introduction. The short implementation periods for the individual currencies in the years 2019 to 2022 make matters worse here.

Strategic and operational challenges

The introduction of new RFRs requires consideration of multiple aspects and areas within Financial services providers and their market environment. By way of example, the following points may be mentioned:

Milestone planning for the implementation of requirements considering the various timelines of the respective working groups

- Review and reorientation of internal hedging and (re)-financing strategies
- Adjustment of internal pricing models for the valuation of products and positions
- Analysis of the impact of replacing the old IBORs considering different market conditions (currencies, indices, legal frameworks, customer segments) and decision making on the strategic approach
- Examine and adjust the legal framework of client and counterparty relationships to minimize potential legal risks
- Identification and analysis of necessary adjustments based on the product landscape of the asset, liability and refinancing side of the financial institutions Identification and adaptation of affected processes, IT systems and data interfaces
- Analysis and decision on how to deal with the transitional parallel validity of IBOR and RFR based reference rates (fallback scenarios).

¹ Results of the EMMI testing, regulatory Newsletter "Stock exchanges Newspaper" 2018-10-30

Why the NEXGEN Business Consultants?

Analysis and inventory

Based on many years of experience in regulatory requirements and in-depth knowledge, we have developed an analysis methodology that enables us to efficiently meet new requirements and optimize our products. In addition, we have a wide range of expertise in European reporting requirements and in-depth settlement and product experience.

Project management and controlling

We place our customers at the center of our activities and processes through our efficient, fast and solution-oriented action. Here we pay attention to the professionalism and consistency in project implementation. Successfully completed projects and targeted further education (certification) are our basis for structured and transparent control and successful completion of projects.

High quality and sustainability

Today's and tomorrow's market developments require sustainable expertise, continuous readiness to change as well as professional sales and service from all concerned. For this reason, we strive to achieve the highest level of service quality and therefore sustainable customer satisfaction based on our management system and the quality standards it contains.

Your contact person from NEXGEN



Guido Becker
Managing Partner
Tel. +49 151 22 33 33 75
E-Mail: guido.becker@nexgenbc.com



Ann-Katrin Seidel
Senior Consultant
Tel. +49 160 93 96 10 87
E-Mail: ann-katrin.seidel@nexgenbc.com

Disclaimer:

Although the greatest possible care has been taken in the preparation of this presentation, errors and omissions excepted. The statements made in the presentation are based on assessments, historical data and legal assessments at the time of preparation of the presentation. All information contained in this presentation is provided without guarantee of accuracy and completeness. The presentation is provided for the internal use of the recipient only. The presentation does not constitute legal or investment advice. This must be done individually, considering the circumstances of the individual case.