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Research & Publications

LIBOR Reform Update

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Overview

- **Main updates**

- GBP, CHF, JPY, EUR Libor and EONIA discontinuation imminent, final publication dates:
 - 31st December 2021 for GBP, EUR, CHF and JPY Libor
 - 3rd January 2022 for EONIA
- FCA Statement on "Synthetic Libor"
- ISDA Supplement 82 regarding GBP ICE Swap Rates

- **Legacy trade conversion**

- Basis Swap conversion event at LCH completed (2nd Oct)
- EONIA/ESTR conversion event at LCH completed (16th Oct)
- GBP, JPY, CHF and EUR Libor CCP conversion events in December
- ICE Short Sterling Futures and Options and EuroSwiss Futures conversion in December

- **Coremont analytics support for:**

- RFR Swaptions and CMS
- RFR Cross Currency Swaps
- Listed Sonia Futures, Options and MidCurve Options
- Persistent basis between SOFR + ISDA fallback and 3M USD Libor

Consolidated Timeline 2021

- End Q1 – No new risk on GBP Libor linear derivatives^{1,2}
- End Q2 – No new risk on GBP Libor non-linear derivatives^{1,2}
- End Q2 – No new risk on GBP exchange traded derivatives expiring post 2021²
- End Q2 – New CHF swaps to reference SARON instead of CHF Libor³
- End July – New JPY swaps to reference TONA instead of JPY Libor⁴
- During Q2/Q3 – Cease initiating new cross-currency derivatives with a GBP Libor leg²
- 30th Sep – LCH commence monthly charge per-ticket on outstanding CHF/EUR/GBP/JPY Libor referencing contracts (not FRAs or USD)⁵

- 2nd Oct – LCH Basis swap split⁵
- 16th Oct – LCH EONIA to €STR swap conversion^{5, 6}
- 4th Dec – LCH, JSCC and CME CHF, JPY and EUR Libor to RFR swap conversion^{7, 8}
- 17th Dec – ICE, conversion of Short Sterling Futures and Options and EuroSwiss Futures into RFR equivalents⁹
- 18th Dec – LCH and CME GBP Libor to SONIA swap conversion^{7, 8}
- 31st Dec – Last publication of CHF, EUR, GBP and JPY Libors
- 31st Dec – No new risk on USD Libor¹⁰
- 3rd Jan 2022 – Last publication date of EONIA

Market migration to RFR referencing derivatives

Trading in GBP, JPY and CHF has recently shifted from Libor to “Risk-free”-rate (RFR) alternatives. In particular Listed Sonia futures and options are trading along with swaptions vs SONIA and TONAR. Cross currency basis swaps have started to trade in RFR vs SOFR.

Available RFR market data is also growing with Broker screens for swaptions, caps/floors and cross currency basis swaps appearing - however we expect that that Brokers will not switch off their Libor screens in the near future.

USD Libor publications will continue until June 2023 but new risk is not expected to reference USD Libor post 2021¹⁰.

FCA announcement of “Synthetic” Libor fixings post 2021

The FCA have announced¹¹ that they will compel the continued publication of “synthetic” 1M, 3M and 6M GBP and JPY Libor Fixing for a limited period post 2021.

These Fixing publications will be not be “representative” as defined by the Benchmarks Regulation (BMR). The synthetic Fixings would be for use in legacy contract only – prohibited for new trading – and do not change the cessation deadline for non-USD Libor.

The FCA’s current proposal is that these synthetic Libors could be used in any legacy contract apart from cleared derivatives. A consultation¹² on this closed on the 20th Oct and the FCA will finalise a decision by year end.

In order to avoid “in arrears” publication, the synthetic methodology¹³ uses a forward looking term rate – this is in contrast to the ISDA fallbacks. The ICE Term Sonia Reference Rate will be used for GBP and the Tokyo Term Risk Free Rate for JPY. The ISDA spread adjustment will be added on top of these term rates.

Cash settled swaptions and CMS: ISDA Supplement 82

ISDA have published a Supplement¹⁴ which affects contracts referencing the GBP LIBOR ICE Swap Rate fixing post a Libor cessation. Currently this applies to GBP only, work is ongoing for JPY and ISDA are expected to publish a supplement addressing JPY LIBOR Tokyo Swap Rate shortly.

Post discontinuation derivatives referencing the GBP LIBOR ICE Swap Rates (GBP cash settled swaptions and CMS) will fall back on the Published GBP ISR Fallback Rate (if any) and failing that the Calculated ISR Fallback Rate.

The Calculated ISR Fallback Rate is based on the GBP SONIA ICE Swap Rate combined with the ISDA fallback spreads and a convexity adjustment.

This Supplement will need to be agreed/enacted on a counter party basis.

Physically settled Libor swaptions

Libor swaptions expiring post discontinuation may specify delivery into a cleared swap that is no longer eligible for clearing. LCH¹⁶ and CME¹⁷ are proposing, for a limited time, to automatically convert the Libor swap submitted into its equivalent cleared RFR swap.

Clearing House conversion of OTC Libor basis swaps

Over the weekend of 1st Oct LCH split any GBP, CHF or JPY Libor referencing basis swaps into two separate fix-float swaps. Basis swaps on these currencies are no longer cleared by LCH. This was a preparatory event for the main Libor to RFR conversions scheduled for December.

LCH's monthly fee per outstanding CHF/EUR/GBP/JPY Libor referencing product (excl. FRAs) came into effect at the end of September.

EONIA/€STR swap conversion – 15th Oct

EONIA will be discontinued¹⁶ on the 3rd Jan 2022. Over the weekend of 15th Oct 2021 LCH converted all cleared EONIA swaps to €STR swaps. LCH no longer clears EONIA.

Mechanically EONIA was replaced by €STR on the floating leg with no change to the fixed leg. LCH provided cash compensation for the 8.5 basis point difference between EONIAS and €STR. This resulted in a small change in discounting risk.

LIBOR/RFR swap CCP conversions

Q4 of this year will see Central Clearing Houses (CCP) convert outstanding Libor referencing products to their RFR equivalent. Post conversion dates Libor referencing swaps will no longer be eligible for clearing.

The conversion process will be similar between the clearing houses, with LCH, JSCC (JPY only) and CME converting on the same dates (see timeline).

- Libor swaps will be unwound and replaced by RFR swaps to maintain the risk profile
- The RFR swap fixed leg will keep the same rate as the Libor swap
- The floating leg of the RFR swap will be adjusted by the relevant ISDA fallback spread
- Cash adjustments will be made for any valuation change

More information and Clearing House specific details are available for LCH⁷, CME⁸ and JSCC¹⁵.

Exchange conversion of Libor based STIR Futures and Options

CE intend to convert all open interest in Short Sterling Futures and Options and EuroSwiss Futures into contracts referencing the replacement RFR⁹ over the weekend of 17th Dec 2021. After this date it will not be possible to trade the legacy contracts. Libor futures will be exchanged for RFR futures on a month and notional equivalent basis at the theoretical fallback spread.

Short Sterling Future Options will be converted into "Flex Strike" Sonia options. The flex strike will be set to the Libor strike + fallback spread and they will be listed until they expire. The expiry date of the new options will be 5 days less than the original option – this change of terms will be compensated for.

Clarion Analytics

With trading in RFR growing quickly support has been added for SONIA and TONAR swaptions, SONIA listed Futures and Options and RFR cross currency swaps. RFR CMS options and RFR Caps/Floor support will be rolled out in the coming weeks.

Clarion's analytics have also been extended to handle the persistent basis seen between RFR curves plus ISDA fallback spread and raw Libor quotes mentioned in our previous update.

Finally, the GBP Libor "cliff-edge" persists with a large jump as we move from Panel Bank submitted quotes to the ISDA fallbacks post discontinuation.

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