IBOR Reform Update

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Our journey today

1. A quick refresher on IBOR reform
2. What's not changing: timeline and BBSW
3. Updates from the key industry bodies
4. RFRs in the market
5. Changes to accounting standards
6. What should you do now?
7. Questions

A Quick Refresher

- In July 2017, the FCA said markets should not rely on LIBOR after 2021
- Due to low liquidity in interbank market and rate rigging scandals
- Working groups were set up for each currency for which LIBOR is published (GBP, USD, EUR, CHF and JPY) with a view to identifying alternative benchmark rates

Risk Free Rates

Currency	RFR
Sterling	Sterling Overnight Index Average (SONIA)
U.S. Dollars	Secured Overnight Financing Rate (SOFR)
Euros	Euro Short-Term Rate (€STR)
Swiss Francs	Swiss Averaged Rate Overnight (SARON)
Japanese Yen	Tokyo Overnight Average Rate (TONAR)

What's not changing (despite COVID-19)?

- Timing:
  - No change to overall timing: still to be ready before end of 2021
  - Interim milestones for loans pushed back slightly

- BBSW will continue

Non-LIBOR Currencies

Currency	IBOR	Anticipated approach
AUD	BBSW	BBSW to continue AONIA (Cash Rate) as alternative
CAD	CDOR	CDOR to continue CORRA as alternative
HKD	HIBOR	HIBOR to continue HONIA as alternative
SGD	SIBOR	SIBOR (reformed) to continue

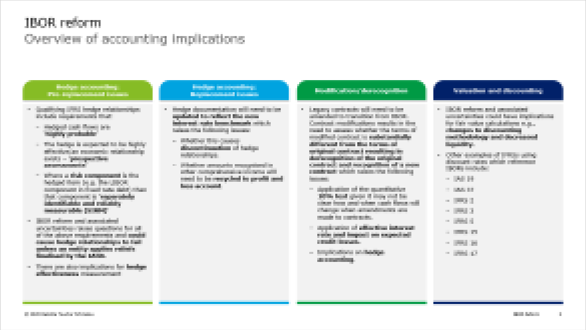
Current approaches in various markets

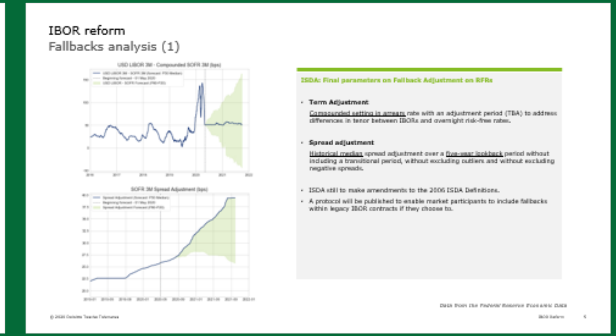
- ISDA consultations and amendments to ISDA Definitions
- Benchmark Supplement 2018 and Adherence protocols

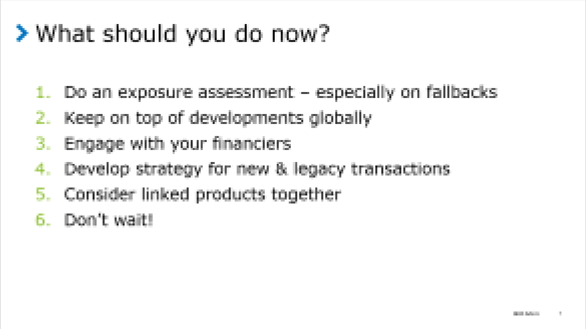
- "Hardwired approach"
- "Amendment approach"
- "Hedged Loan Approach"
- Proposed NY State legislation

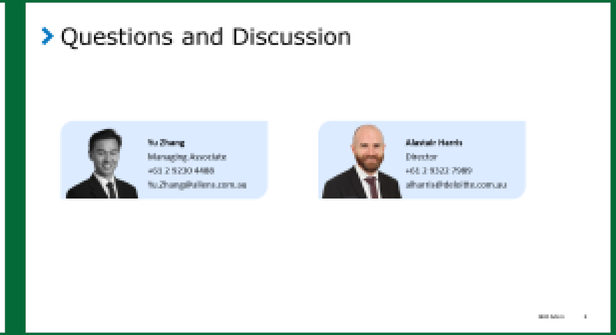
- LMA exposure drafts (Sep 2019)
- APLMA survey (Feb 2020)

On the road to transition









IBOR reform

Overview of accounting implications

Hedge accounting: Pre-replacement issues

- Qualifying IFRS hedge relationships include requirements that:
  - Hedged cash flows are '**highly probable**'
  - The hedge is expected to be highly effective/an economic relationship exists – '**prospective assessments'**
  - Where a **risk component** is the hedged item (e.g. the LIBOR component in fixed-rate debt) then that component is '**separately identifiable and reliably measurable (SIRM)**'
- IBOR reform and associated uncertainties raises questions for all of the above requirements and **could cause hedge relationships to fail unless an entity applies reliefs finalised by the IASB.**
- There are also implications for **hedge effectiveness** measurement

Hedge accounting: Replacement issues

- Hedge documentation will need to be **updated to reflect the new interest rate benchmark** which raises the following issues:
  - Whether this causes **discontinuation** of hedge relationships.
  - Whether amounts recognised in other comprehensive income will need to be **recycled to profit and loss account**.

Modification/derecognition

- Legacy contracts will need to be amended to transition from IBOR. Contract modifications results in the need to assess whether the terms of modified contract is **substantially different from the terms of original contract resulting in derecognition of the original contract and recognition of a new contract** which raises the following issues:
  - Application of the quantitative **10% test** given it may not be clear how and when cash flows will change when amendments are made to contracts.
  - Application of **effective interest rate and impact on expected credit losses.**
  - Implications on **hedge accounting**.

Valuation and discounting

- IBOR reform and associated uncertainties could have implications for fair value calculations e.g., **changes to discounting methodology and decreased liquidity.**
- Other examples of IFRSs using discount rates which reference IBORs include:
  - IAS 19
  - IAS 37
  - IFRS 2
  - IFRS 3
  - IFRS 5
  - IFRS 15
  - IFRS 16
  - IFRS 17

IBOR reform

Removing obstacles in the road to transition

26 September 2019
Phase I Amendments to the Standards Issued, available for early adoption

9 April 2020
ED/2020/1 Interest Rate Benchmark Reform — Phase 2 published

25 May 2020
ED/2020/1 Interest Rate Benchmark Reform — Phase 2 comments closure

Q3 2020
Phase II Amendments to the Standards expected to be issued

Phase 1
Status: Implemented

Phase 2
Status: Exposure Draft

Hedge accounting: Pre-replacement

Interest Rate Benchmark Reform—Amendments to IFRS 9, IAS 39 and IFRS 7: applicable from 1 January 2020

- These amendments provide temporary exceptions to specific hedge accounting requirements, so that entities apply these hedge accounting requirements assuming that the interest rate benchmark is not altered as a result of the IBOR reform. These exceptions were put in place to avoid entities having to discontinue hedging relationships solely due to the uncertainty arising from IBOR reform.

Hedge accounting: Replacement

- Introduce an exception to the existing requirements so that changes in the hedge documentation necessary to reflect modifications to the hedged item, hedging instruments or hedged risk that are required as a direct consequence of IBOR reform and are done on an economically equivalent basis, do not result in the discontinuation of hedge accounting or the designation of a new hedging relationship.

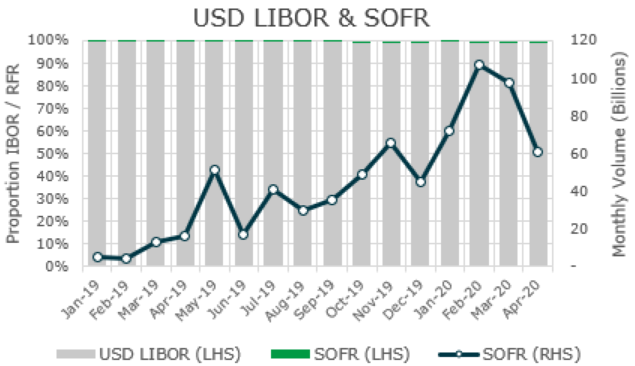
Modification/derecognition

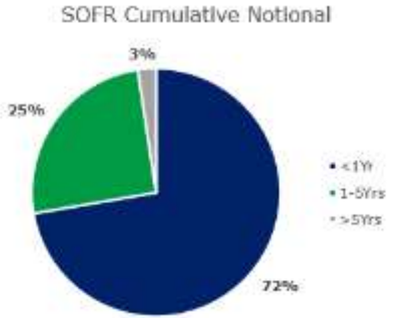
- As a practical expedient, apply IFRS 9:B5.4.5, such that the change to the contractual cash flows is applied prospectively by **revising the effective interest rate**.
- This practical expedient only applies when the modification is required as a direct consequence of interest rate benchmark reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis (i.e. the basis immediately preceding the modification).

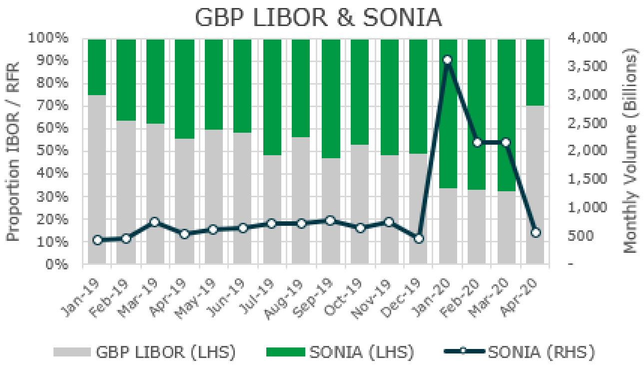
Valuation and discounting

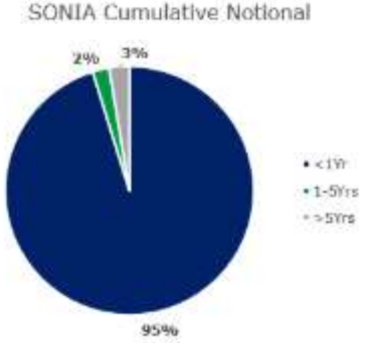
- Given the similarity of financial liabilities in IFRS 9 and lease liabilities in IFRS 16, the IASB is proposing a similar practical expedient in IFRS 16. The practical expedient applies when the interest rate benchmark on which lease payments are based is changed as a direct consequence of IBOR reform and the change is done on an economically equivalent basis.
- The ED proposes to amend IFRS 4 to require insurers that apply the temporary exemption from IFRS 9

IBOR reform
Liquidity update





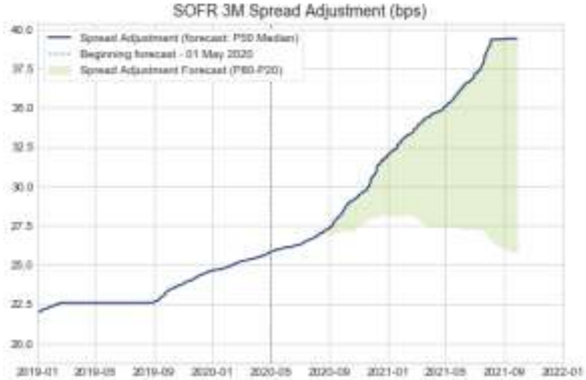




Data from ISDA OTC (DTCC & BBG SDRs)

IBOR reform

Fallbacks analysis (1)



ISDA: Final parameters on Fallback Adjustment on RFRs

- **Term Adjustment**

  Compounded setting in arrears rate with an adjustment period (TBA) to address differences in tenor between IBORs and overnight risk-free rates.

- **Spread adjustment**

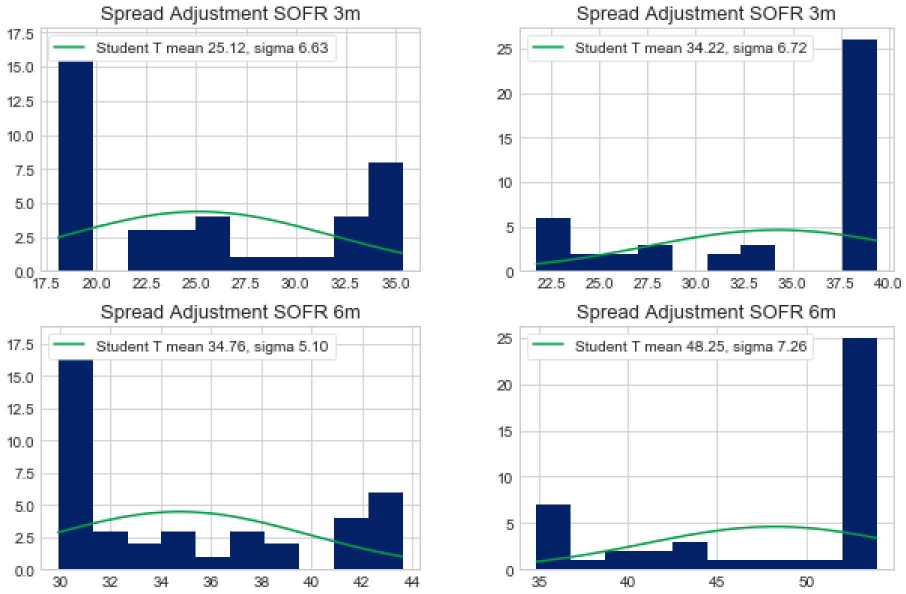
  Historical median spread adjustment over a five-year lookback period without including a transitional period, without excluding outliers and without excluding negative spreads.

- ISDA still to make amendments to the 2006 ISDA Definitions.
- A protocol will be published to enable market participants to include fallbacks within legacy IBOR contracts if they choose to.

Data from the Federal Reserve Economic Data

IBOR reform
Fallbacks analysis (2)

31 Jan 2020 | 1 May 2020



Impact from recent market volatility

- Shock in the market has caused a wider spread between the IBOR curves with their respective compounded RFRs.
- Extrapolating the remaining time period, using historic rates, the Spread adjustment for
    - SOFR 3M pre-COVID was expected to be around **25 bps**, now it is **34 bps**.
    - SOFR 6M pre-COVID was expected to be around **35 bps**, now it is **48 bps**.

Data from the Federal Reserve Economic Data

What should you do now?

1. Do an exposure assessment – especially on fallbacks
2. Keep on top of developments globally
3. Engage with your internal IBOR transition team
4. Develop strategy for new & legacy transactions
5. Consider linked products together
6. Don’t wait!

Questions and Discussion

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