Interbank Offered Rates (IBOR) Transition.

Frequently Asked Questions.

What are IBORs?

Interbank Offered Rates (IBORs) are globally recognised interest rate benchmarks that are intended to represent the average rates at which large international banks lend to each other in the wholesale unsecured funding market and are calculated based on submissions by a panel of qualifying banks.

IBORs are used for a wide range of purposes including the pricing of loans, debt and derivatives. They are available in a number of currencies, generally for a number of tenors or maturities. The most well known IBOR is the London Interbank Offered Rate (LIBOR) which is quoted for 7 tenors in each of 5 currencies (USD, GBP, EUR, CHF & JPY).

Due to systemic risks associated with declining market liquidity in the interbank funding markets, global regulators are moving to replace IBORs with a new set of benchmark rates, known as alternative reference rates (ARRs), from the end of 2021.

What is changing?

The universe of IBORs can be divided between those that are expected to continue to be published, but with reforms to methodology and governance, and those that are at risk of being discontinued due to concerns that reforms cannot adequately address issues of reliability and robustness.

The reformed IBORs include the Euro Interbank Offered Rate (EURIBOR), the Australian Dollar Bank Bill Swap Rate (BBSW), the New Zealand Dollar Bank Bill Market Rate (BKBM), and the Hong Kong Interbank Offered Rate (HIBOR). The reformed IBORs have a calculation methodology that is grounded in actual transactions and governed by a framework addressing conflicts of interest, and that meets the requirements of the IOSCO Principles for Financial Benchmarks and, where applicable, the EU Benchmark Regulation.

However, for certain other IBORs (including LIBOR), reforms to the calculation methodology have not wholly addressed the issues of reliability and robustness. Global financial regulators have repeatedly expressed the view that these IBORs are unsustainable and have directed market participants to find replacement interest rate benchmarks.

Even where a reformed IBOR is expected to continue, market participants may need to consider whether that IBOR remains the most appropriate interest rate benchmark for their purposes as outlined by IOSCO in its Statement on Matters to Consider in the Use of Financial Benchmarks.

What is driving the change to IBORs?

There has been a global regulatory focus on strengthening key benchmark rates for some years now, particularly on ensuring benchmarks are based upon actual transactions in the underlying market to the greatest extent possible. Interest rate benchmarks are a central focus of these efforts.

Global financial regulators are concerned that the interbank lending market, which IBORs are intended to reflect, is no longer sufficiently active or liquid as regulatory reforms introduced following the 2008 financial crisis have made unsecured interbank borrowing less attractive. Given the lack of liquidity in the underlying interbank lending market, IBOR panel banks are increasingly relying on ‘expert judgement’ to determine submissions. This raises questions about whether the IBORs meet current regulatory expectations for reliability and robustness and also raises concerns for panel banks over potential liability for submissions which make participation in the panel less attractive.

Why is transitioning away from IBORs a major change?

IBORs play a key role in the global financial markets. IBORs are used to calculate payments in many currencies under many types of financial instruments including derivatives, loans (including mortgages and student loans), floating rate notes, securitisations and deposits. They may also be used to determine valuations for liability management and for other financial management processes.

The role of IBORs in the financial markets is hardwired into documentation, systems and infrastructure meaning that any move to alternative interest rate benchmarks is complex and may give rise to financial and operational risks.

The most widely used IBOR is LIBOR and it is estimated that there are currently over $370 trillion of exposures[1] which are referenced to LIBOR internationally.

What is the timing of the transition?

The UK Financial Conduct Authority (FCA) has said that after the end of 2021 it does not intend to use its influence or legal powers to sustain LIBOR.

The FCA's Edwin Schooling Latter, Director of Markets and Wholesale Policy, acknowledged in a speech[2] on 21 November 2019 that "market participants need to be ready for life without LIBOR" by the end of 2021 and "the best way to avoid LIBOR-related risks is to move off LIBOR altogether". Other global regulators, such as the Federal Reserve Bank of New York and the Australian Securities and Investments Commission, have reinforced the FCA's message.

Most other IBORs that are being replaced are working toward similar timeframes, although clients should check with the relevant regulators and ARR/industry working groups in the relevant jurisdictions for exact timetables.

How do ARRs differ from IBORs?

ARRs and IBORs are not economic equivalents. The ARRs are described as "nearly risk-free rates" as they are calculated daily by reference to actual overnight money market transactions.

As a result, ARRs are backward-looking rates that are perceived to have very little credit risk. In contrast, the IBORs are forward-looking, incorporating both a term structure and bank credit risk. The structural differences between the ARRs and IBORs mean that they may perform differently. ARR-based term rates may be developed for some currencies in order to provide an alternative rate that shares the forward-looking term structure features of the IBORs. However, it's unclear if or when such ARR-based term rates will be ready to use so it is important that clients develop an understanding of the ARRs.

Feature	IBOR	ARR
Calculation basis	• Panel bank submissions (i.e. increasingly upon expert judgement).	• Observable transactions.
Term structure	• Multiple forward-looking tenors (e.g. LIBOR published across seven tenors, from overnight to 1 year).	• Overnight only (i.e. no term structure).
Credit risk	• Includes a bank credit premium (i.e. likely to move significantly in times of credit market stress).	• No bank credit risk. • Some ARRs are secured/ collateralised, and are therefore effectively risk-free (e.g. SOFR and SARON in the US and Switzerland respectively). • Other ARRs are unsecured/ uncollateralised though still do not have a large credit premium embedded.

What is the transition approach for key currencies?

The table below shows the key IBORs, their alternate rate, and the expected approach from the end of 2021.

Currency	IBOR	Alternate Rate	Expected Approach
AUD	**BBSW**	BBSW was reformed in 2018 to introduce a new transaction-based methodology. The AUD Overnight Index Average (AONIA), also known as the RBA Overnight Cash Rate, is a pre-existing benchmark that has been designated as the fallback ARR for BBSW by the International Swaps and Derivatives Association (ISDA).	BBSW and AONIA are both expected to continue and market participants will need to select the most appropriate benchmark for their purposes.
CHF	**CHF LIBOR**	SARON (Swiss Average Rate Overnight) is an existing rate and the nominated alternative to CHF LIBOR.	The FCA has indicated that "market participants need to be ready for life without LIBOR" by the end of 2021 and "the best way to avoid LIBOR-related risks is to move off LIBOR altogether".[2] This would mean transitioning from CHF LIBOR to SARON.
EUR	**EURIBOR**	Reforms to EURIBOR are underway. €STR is the nominated alternative to EURIBOR.	EURIBOR and €STR are both expected to continue and market participants will need to select the most appropriate benchmark for their purposes.
EUR	**EUR LIBOR**	€STR (Euro Short-Term Rate) is the nominated alternative to EUR LIBOR and commenced on 2 October 2019.	The FCA has indicated that "market participants need to be ready for life without LIBOR" by the end of 2021 and "the best way to avoid LIBOR-related risks is to move off LIBOR altogether".[2] This would mean transitioning from EUR LIBOR to €STR.
GBP	**GBP LIBOR**	SONIA (Sterling Overnight Index Average), administered by Bank of England, is the nominated alternative to GBP LIBOR. It was reformed on 23 April 2018.	The FCA has indicated that "market participants need to be ready for life without LIBOR" by the end of 2021 and "the best way to avoid LIBOR-related risks is to move off LIBOR altogether".[2] This would mean transitioning from GBP LIBOR to SONIA.
HKD	**HIBOR**	HONIA (Hong Kong Overnight Index Average), the RFR for HKD, is a pre-existing rate. HIBOR (Hong Kong Interbank Offered Rate) has been subject to a number of reforms and may be further reformed in the future.	HIBOR and HONIA are expected to continue and market participants will need to select the most appropriate benchmark for their purposes.
JPY	**JPY LIBOR**	TONAR (Tokyo Overnight Average Rate), the RFR for JPY is an existing rate and is the nominated alternative to JPY LIBOR.	The FCA has indicated that "market participants need to be ready for life without LIBOR" by the end of 2021 and "the best way to avoid LIBOR-related risks is to move off LIBOR altogether".[2] This would mean transitioning from JPY LIBOR to TONAR or another appropriate JPY interest rate benchmark.

Currency	IBOR	Alternate Rate	Expected Approach
JPY	**TIBOR (Japanese Yen TIBOR and Euroyen TIBOR)**	TIBOR (Tokyo Interbank Offered Rate) is being reformed. TONAR is the nominated alternative.	Euroyen TIBOR may be discontinued. Japanese Yen TIBOR and TONAR are expected to continue and market participants will need to select the most appropriate benchmark for their purposes.
NZD	**BKBM**	The New Zealand Financial Markets Association is consulting on a fallback benchmark interest rate for BKBM to ensure that benchmark remains fit for purpose.	To be determined – announcement expected in 2020.
SGD	**SIBOR (Singapore Interbank Offered Rate)**	SIBOR is being reformed and the nominated alternative is SORA.	SIBOR and SORA are expected to continue and market participants will need to select the most appropriate benchmark for their purposes.
SGD	**SOR (Swap Offer Rate) Note: SOR is calculated with reference to USD LIBOR.**	SOR is calculated with reference to USD LIBOR. SOR is expected to be replaced by SORA (Singapore Overnight Rate Average), an existing overnight rate.	Transition to SORA. The Association of Banks in Singapore (ABS) and the Singapore Foreign Exchange Market Committee (ABS-SFEMC) will start the consultation process in early 2020.
USD	**USD LIBOR**	SOFR (Secured Overnight Financing Rate) was introduced in April 2018 is the nominated ARR to USD LIBOR.	The FCA has indicated that “market participants need to be ready for life without LIBOR” by the end of 2021 and “the best way to avoid LIBOR-related risks is to move off LIBOR altogether”.[2] This would mean transitioning from USD LIBOR to SOFR.

Will the Bank Bill Swap Rate (BBSW) and Bank Bill Benchmark Rate (BKBM) remain?

Yes, although possibly not all tenors. Australia uses the Bank Bill Swap Rate (BBSW) and New Zealand uses the Bank Bill Benchmark Rate (BKBM), both of which have been reformed and are currently considered sufficiently reliable and robust due to the higher rate of transactions in the underlying market permitting a calculation methodology that is grounded in actual transactions.

In Australia, there is some ongoing industry discussion in relation to shorter dated BBSW rates. In particular, the liquidity underlying 1 month BBSW has decreased as banks have less incentive to issue very short-term paper due to changes to the liquidity-coverage ratio. Reserve Bank of Australia Deputy Governor Guy Debelle suggested in a speech[3] on Interest Rate Benchmark Reform in May 2018 that users of products referencing 1-month BBSW should consider referencing 3 or 6-month BBSW. However, at present, there has been no decision made in relation to shorter-dated BBSW rates.

The alternative reference rate to BBSW is the Australian Interbank Overnight Cash Rate (AONIA). The New Zealand Financial Markets Association is consulting on a fallback benchmark interest rate for BKBM. As outlined by IOSCO in its Statement on Matters to Consider in the Use of Financial Benchmarks, clients may need to consider which is the most appropriate interest rate benchmark for their purposes and consider their contingency plans in the event a benchmark is no longer available or materially changes.

What will happen to legacy IBOR trades after 2021?

The FCA's Edwin Schooling Latter, Director of Markets and Wholesale Policy, acknowledged in a speech[(2)] on 21 November 2019 that "we do not know precisely how the LIBOR 'end-game' will play out". In addition, the nature of any impact for a client will depend on a range of factors including, but not necessarily limited to:

- the type of IBOR-linked product or service the client has exposure to;
- what (if any) fallback terms are included within current documentation for that product or service; and
- the systems or infrastructure needed to support that product or service.

For example, fallback terms may identify a successor rate if the IBOR used by a particular product is unavailable. However, some fallback terms do not adequately provide for permanent cessation of the IBOR and some product documentation does not include any fallback terms at all. Fallback terms may need to be strengthened and, even then, may not mitigate against IBOR risks as effectively as actively transitioning away from the relevant IBOR.

It is important for a client to carefully consider the nature of its IBOR exposure and how it may be impacted in the different 'end game' scenarios that could play out. Some industry associations are coordinating the development of market consensus on treatment of legacy IBOR products and services, such as the LMA (Loan Market Association based in London), the APLMA (Asia Pacific Loan Market Association based in Hong Kong), the LSTA (Loan Syndications and Trading Association based in the US) and ISDA (International Swaps and Derivatives Association).

For more information, refer to the Westpac IBOR dislosure statements.

How does the IBOR transition impact the products and services offered by Westpac?

The IBOR transition may impact the products and services offered by Westpac and may result in changes to the availability or terms of certain existing products and services or the introduction of new products or services. In some cases, Westpac may need to discuss with the client changing the terms of a product or service already held or received by the client.

Westpac is aware that any changes will require careful consideration of a range of factors including, but not necessarily limited to:

- the nature of the product or service;
- the term of the contract;
- which IBOR is referenced;
- the nature of any fallback terms included in documentation;
- market consensus on risk mitigation steps such as new fallback terms;
- developments regarding systems or infrastructure;
- accounting or tax consequences of changes to the terms of a product or service;
- client demand for the product or service;
- the availability of alternative products or services; and
- the timing and circumstances of any IBOR discontinuation.

Is the ARR market maturing?

The broader market including financial institutions, intermediaries, and regulators, remain in consultation regarding various practical considerations. Market conventions relating to ARRs remain in a state of development.

New reference rates have been established for each of the five major LIBOR currencies, however there remain a number of transition mechanics to work through before the picture will settle, including whether ARR term rates will be developed in time to support the transition of cash products.

All this must occur before the end of 2021 – Westpac has commenced preparation for participation in ARR markets and will keep our customers informed as these become available over time.

When should I look to amend my facilities?

The IBOR Transition journey is ongoing throughout 2020, ahead of final transition activities in late 2021. For customers looking to amend their facilities, it is important that consideration be given to the organisations overall IBOR exposure, the adequacy and maturity profile of applicable documentation, liquidity in the market, and a customer's preparedness to transition.

At this stage, should I update my fallback language or select an ARR?

The nature of any impact for a client will depend on a range of factors including, but not necessarily limited to:

- the type of IBOR-linked product or service the client has exposure to
- what (if any) fallback terms are included within current documentation for that product or service
- the systems or infrastructure needed to support that product or service

The decision whether to refinance to an ARR or to update the fallback language within a contract, is unique to each entity and needs to be carefully considered. Westpac encourages all our customers to seek independent advice in making any decisions around IBOR transition.

What are the costs involved in transitioning?

The impacts of the IBOR Transition will vary between customers, depending on IBOR exposure and changes that may be required. As each customer will need to conduct their own preparations and readiness, the timescale, extent and cost of these activities will vary depending on the level of impact to each customer. Westpac encourages customers to start early in understanding the impact that the IBOR Transition will have on their operations, so they have ample time to mobilise their resources, funds and efforts as required.

How should I prepare for the IBOR transition?

It is important for clients to understand the financial and operational impact of IBOR transition. Westpac suggests that clients could start by considering:

- which products and services they use that reference an IBOR;
- whether the relevant contracts extend beyond 2021;
- whether documentation includes any terms such as fallback terms that provide adequate risk mitigation;
- the systems and infrastructure that may require updating;
- the accounting and tax consequences of changes to the terms of products or services; and
- the appropriateness of alternative benchmark interest rates, such as the ARRs.

Westpac encourages clients to follow the latest market developments on IBOR transition, such as through participation in initiatives run by industry bodies, and to seek their own professional advice on legal, financial, accounting and tax matters.

How is Westpac preparing for IBOR transition?

Westpac has established a group-wide program to coordinate its global efforts on IBOR transition. The work of this program includes:

- participating in industry working groups on the transition process;
- engaging with clients and counterparties to raise awareness on the discontinuation of IBORs;
- assessing how IBORs are used in its products and services;
- including more robust fallbacks in new contracts that reference an IBOR;
- developing products that reference ARRs;
- updating its systems and processes to be able to cater for the ARRs; and
- in due course, contacting clients with IBOR referenced contracts which extend beyond 2021 to determine any documentation amendments which will be required to cater for the transition to ARRs.

Westpac has advised its regulators on the establishment and progress of the program and will continue to provide regulatory progress reports throughout the IBOR transition period.

If I have any further questions relating to IBOR transition, who can I contact?

Please contact the Westpac IBOR Transition Team - IBORUpdates@westpac.com.au

References.

1 International Swaps and Derivatives Association: The $370 Trillion Benchmark Challenge (5/2/18)

2 Edwin Schooling Latter, Director of Markets and Wholesale Policy, Financial Conduct Authority: Next steps in transition from LIBOR (21/11/19)

3 Guy Debelle, Deputy Govenor, Reserve Bank of Australia: Interest Rate Benchmark Reform (15/5/18)

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