Transition Index Program

June 2020

Getting ready for the Benchmark transition

Major structural changes in global financial markets regarding interest rate benchmarks are now underway. Central banks and regulators in a number of key jurisdictions are committed to a transition away from the various Interbank Offered Rates (IBORs) to alternative rates expected to be more robust and less vulnerable to manipulation. The London Interbank Offered Rate (LIBOR) is the most commonly used IBOR.

The IBORs represent an average of the rates at which Panel Banks believe that they could borrow money in various currencies in the interbank market and reflect both the interest rate environment and the expected credit and liquidity risks faced when lending on the interbank market. Today, the IBORs are widely used as benchmark rates in financial transactions, including in the derivatives, bonds, loans, and structured markets but the IBORS are widely anticipated to be discontinued or become less reliable as regulatory support for the rates is withdrawn at the end of 2021.

A variety of within Risk Free Rates (RFRs) have been proposed by regulatory authorities and industry working groups as alternative benchmark rates to replace the IBORs. Regulators and industry groups are encouraging and supporting the transition to these alternative rates as further described below.

Should you have any questions, please reach out: bal-ibortransition@natixis.com or your usual sales representative or relationship manager.

Transitioning from IBORs to alternative rates requires replacing the interest rate benchmarks used for financial transactions and will impact Natixis products which reference IBOR or are hedged using IBOR.

Natixis is actively involved participates, in preparing the transition from the IBORs and is committed to assist its clients throughout the process. Natixis will continue its involvement in industry groups and to support market initiatives to reach a consensus on fair replacement rates and ensure that its clients are provided with the necessary information.

RFR Working Groups:

- Bank of England: https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor
- European Central Bank: https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html
- Federal Reserve Board and Federal Reserve Bank of New York: https://www.newyorkfed.org/arrc
- Swiss National Bank: https://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates
- Bank of Japan: https://www.boj.or.jp/en/paym/market/sg/index.htm/

Why are IBORs reformed?

Following the LIBOR scandal in the 2010's, the G20 asked the Financial Stability Board (FSB) to undertake a fundamental review of major interest rate benchmarks in response to manipulation events and a decline number of market transactions used to calculate LIBOR. The FSB set up various working groups with central banks and regulatory authorities to provide the review.

The FSB suggested a 'multi-rate' approach to reforming interest rate benchmarks across currencies, with the objective to:

- Strengthen existing benchmarks to the greatest extent possible with transactions data and better governance processes across contributors,
- Develop RFRs.

What are the alternative Benchmarks considered?

At the time of the FSB review, the proposed alternative rates were seen by regulators as being more representative and reliable than the IBORs as their calculation is based on actual transactions, which is expected to reduce the risk of manipulation.

Alternative RFRs by currency:

Jurisdiction	Working Group	Preferred alternative rate	Nature	Administrator	1st publication date
	Alternative Reference Rates Committee – ARRC	*Secured Overnight Financing Rate (SOFR)*	*Secured*	*Federal Reserve Bank of New York*	*April 3rd 2018*
	Working Group on Sterling Risk Free Reference rates	*Reformed Sterling Overnight Index Average (SONIA)*	*Unsecured*	*Bank of England*	*April 23rd 2018*
	Study Group on Risk Free Reference Rates	*Tokyo Overnight Average rate (TONAR)*	*Unsecured*	*Bank of Japan*	*Already published prior reform*
	National Working Group on CHF Reference Rates	*Swiss Average Rate Overnight (SARON)*	*Secured*	*SIX Swiss Exchange*	*Already published prior reform*
	Working Group on Risk Free Reference Rates for the Euro Area	*Euro Short Term Rate (€STR)*	*Unsecured*	*European Central Bank*	*October 2nd 2019*

While alternative RFRs for each of the IBOR currencies have now been identified, the pace of the transition has been uneven across jurisdictions.

What are the main differences between IBORs and RFRs?

RFRs are fundamentally different from the IBORs:

1. Backward-looking: RFRs are overnight rates and are published at the end of the overnight borrowing period). This means they are "backward-looking", in other words calculated by reference to historical data. By contrast, the IBORs have a term element (i.e. the rate relates to a borrowing period of 3 months, 6 months) and are published at the beginning of the borrowing period, meaning that the IBORs are "forward-looking".

2. No or reduced bank credit risk premium: the IBORs include a premium based on interbank credit risk (i.e. an additional amount to account for the risk that the borrowing bank may not be able to repay the interbank borrowing). RFRs either do not include this premium or include a reduced one.

3. Currency-by-currency: the calculation methodology underpinning the IBORs is uniform across all currencies whereas calculation methodology for RFRs are determined currency-by-currency. SONIA or €STR are based on unsecured markets whereas the SOFR or SARON are based on secured markets.

Are term rates still expected to be published?

At present, no term rates based on RFRs are published even though several RFRs working groups are working on developing forward looking rates. As at today, the backward-looking methodology with compounded interest constitutes an alternative to term rates.

What is the IBOR transition timeline?

Given the broad use of IBORs across almost all markets, jurisdictions and products, regulators and industry groups are encouraging a gradual transition.

EONIA will be last published on January 3, 2022

EURIBOR is BMR compliant and can continue to be used after January 1, 2020 for existing and new contracts / instruments. The working group is also looking at identifying €STR-based fallbacks for EURIBOR for a scenario in which EURIBOR may permanently cease to exist.

LIBOR is expected by the Financial Conduct Authority (FCA) to stop being relied on by firms after the end of 2021. On March 25, 2020, in light of the coronavirus outbreak, the FCA, supervisor of ICE (administrator of LIBOR) stated: "*The central assumption that firms cannot rely on LIBOR being published after the end of 2021 has not changed and end-2021 should remain the target date for all firms to meet.*"

How the IBOR transition will impact Natixis' clients?

The IBOR transition will impact many of the products and services offered by Natixis to its clients, whether currently or in the future. Despite remaining areas of uncertainty, Natixis encourages its clients to consider the transition to alternative RFR referenced products.

Prior to subscribing to or purchasing any new IBOR-linked products, you may wish to:

a. Review products referencing IBOR and understand that, during the lifetime of the product, the applicable rate may cease to be published by the end of 2021;

b. Understand how the fallback provisions (i.e. contractual provisions dealing with the process by which the new rate shall replace the IBOR) of the product would operate, bearing in mind that further changes may affect the product and that additional action may be required or become necessary as the market continues to evolve in response to the IBOR reform;

c. Familiarize yourself with RFRs and what their use means for you / your business given the significant differences between RFRs and the IBORs;

d. Consider whether you would need to seek external advice in order to prepare/manage your transition (e.g. legal, accounting, tax, etc.).

Existing products:

Your attention is drawn to the fact that the impact of the IBOR transition on an existing IBOR-linked transaction depends on the terms of the agreed fallback provisions. Such provisions may be industry-wide (i.e. recommended by relevant industry groups such as the International Swaps and Derivatives Association (*ISDA page*), the Loan Market Association (*LMA page*)), or negotiated on a bilateral basis between the counterparties.

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