BBVA
Corporate &
Investment Banking

BBVA Global Transaction Banking

IBOR Transition Information

2022

Creating Opportunities

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01 – Introduction (1/3)

The purpose of this section is to summarise current market trends and latest developments of the industry regarding the IBOR transition. BBVA acts as a financial entity and does not provide financial, legal, tax advice or otherwise nor a personal recommendation.

Timing Considerations

- On 5 March 2021, the FCA announced all LIBOR settings will either cease to be provided by any administrator or no longer be representative:
  - **31 December 2021**: all GBP, EUR, CHF, JPY, and 1-week and 2-month USD LIBOR settings
  - **30 June 2023**: remaining (overnight, 1-month, 3-month, 6-month and 12-month) USD LIBOR settings
- The FCA in order to ease an orderly transition, on **16 November 2021**, confirmed that it will allow **the temporary use of 'synthetic' GBP and JPY LIBOR rates in all legacy LIBOR contracts**, other than cleared derivatives, that have not been changed at or ahead of end-31 December 2021. Synthetic **JPY LIBOR will cease at the end of 2022**, and the availability of synthetic GBP LIBOR is not guaranteed beyond end-2022. These rates are provides for the support of existing contracts, and the new use of synthetic LIBOR is banned for new production.
- A critical step in the necessary shift in global interest rate markets towards **more robust foundations** was reached on **31 December 2021, as GBP, EUR, CHF, JPY, and 1-week and 2-month USD LIBOR** settings were published for the final time. Banks need to continue the transition of legacy USD LIBOR referenced contracts to alternative reference rates such as the Risk Free Rates (RFRs), or include robust fallbacks in contracts that permit rate switch upon LIBOR cessation of loss of representativeness, as soon as practically possible and at least before the USD LIBOR cessation date or lack of representativeness date.
- ISDA and Bloomberg announced the **5 March 2021 as the Spread Adjustment Fixing Date for all LIBOR Tenors across all LIBOR currencies**
- The Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) issued supervisory guidance encouraging banks **"to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021."**

Daily interest rates and Term rates

- RFRs are daily interest rates while LIBORs are term rates.
- There are some term rate curves available for these new RFRs for certain tenors and currencies. The ARRC formally announced its endorsement of **1-month, 3-month and 6-month, 12-month CME Term SOFR Reference Rates.**

BBVA has been working on LIBOR Transition topics for the last 3 years. We are following very closely the recommendations from the Regulatory/Industry Working Groups for each of the new Risk Free Rates (SOFR in US, SONIA in UK, €STR in EU, etc.) and currently our systems are ready to process the recommended new RFR conventions

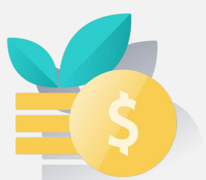
01 – Introduction (2/3)

Alternative rates selected by the Working Groups and approved Term Rates

Country / Region	Reference type	Manager	Cessation current reference rate	RfR Alternative	RfR Manager (*link to RfR Working Group*)	RfR Term Rate	Manager RfR Term Rate
EU	EONIA	EMMI	31/12/2021	**€STR**	European Central Bank (ECB)	**EFTERM** (***EURIBOR** is still applicable*)	EMMI
	LIBOR EUR	ICE BA					
EEUU	LIBOR USD	ICE BA	1w, 2m - 31/12/2021 **o/n, 1m, 3m, 6m, 12m - 30/06/2023**	**SOFR**	New York Fed	**Term SOFR**	CME
UK	LIBOR GBP	ICE BA	31/12/2021	**SONIA**	Bank of England	**Term SONIA**	Refinitiv
							ICE BA
Swiss	LIBOR CHF	ICE BA	31/12/2021	**SARON**	SIX Swiss Exchange	–	–
Japan	LIBOR JPY	ICE BA	31/12/2021	**TONAR**	Bank of Japan	**TORF**	Quick

01 – Introduction (3/3)

Economic concepts measured = Equivalent Result



- **RFRs are designed to be nearly risk-free rates.** As a consequence they do not incorporate any credit or liquidity premium. By contrast most IBORs are designed to provide an indication of the average rates at which submitter banks could obtain wholesale unsecured funding for set periods and incorporates both a credit premium (to reflect term bank credit risk) and a term liquidity premium (to reflect the risk inherent in longer dated funding).

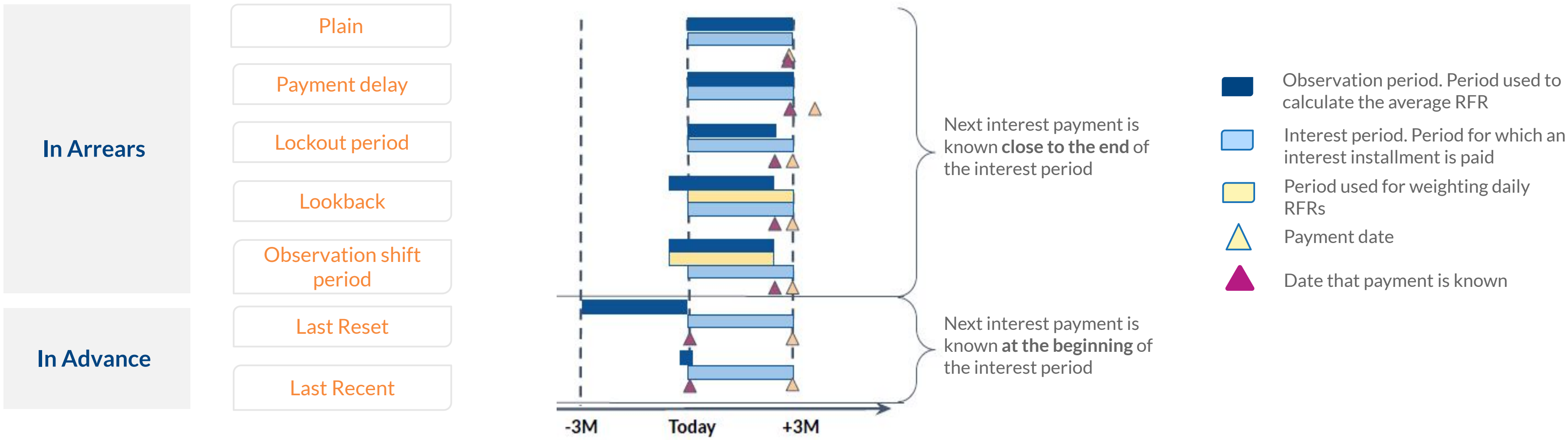
Loan/Discount product referenced to LIBOR	All in rate = LIBOR + Margin
Loan/discount product referenced to LIBOR with RFRs fallback rates	All in rate = Risk Free Rate (RFR) + Credit Adjustment Spread + Margin

- **Risk Free Rates (the Alternative Reference Rate):** Overnight 'risk-free' rate after applying the agreed convention, based on the contract's particular fallback language, for each term rate (e.g. Daily Compounded SOFR in arrears with Lookback)
- **Credit adjustment spread:** This spread is usually calculated following ISDA methodology as the historical median over a five-year lookback period of the difference between the relevant RFR and LIBOR (published by Bloomberg). After the FCA announcement of LIBOR cessation dates, the ISDA credit adjustment spread value published by Bloomberg has been fixed. These fixed values can be found here
- **Margin:** Margin components (include funding costs and commercial margin) would be added to the Fallback Rate (RFR + Credit Adjustment Spread)

02 – Conventions - Interest calculation approaches

Methodologies for computing the overnight rate differ on when the interest rate will be set relative to the interest payment due date.

Daily interest calculation approaches for **simple** or **compounded** **RFR** (Illustrative example):



Some aspects of the **"In Arrears" and "In Advance"** methodologies are provided below:

In Arrears

Lookback vs. **Observation Shift Period**

Lookback

- The observation period used of daily RFR is shifted backwards "n" lag days but the weighting of the daily RFRs remains based on the calendar days of the interest period. Recommended lag is [2 to 5] business days

Observation Shift Period

- Both the observation period used of daily RFR and the weighting of this RFRs shifts backwards "n" lag days. Recommended lag is [2 to 5] business days

In Advance vs forward-looking (term) rate

In Advance method vs. **Forward-looking rates (RFR term rates)**

In Advance method

- Uses historical rates to determine the simple or compounded rate at the start of the interest period.
- Historical rates for the calculation of In Advance are currently available (published RFRs)

Forward-looking rates (RFR term rates)

- Uses forward-looking interest rates which incorporate the market´s projection of future RFRs (e.g. via OIS or futures market) to determine the interest rate at the start of the interest period
- Forward-looking (term) rates require a sufficient level of liquidity in the RFR OIS markets. SOFR Term is published by CME and endorsed by ARRC for 1-month, 3-month and 6-month tenors.

03 – Conventions and Proposed Fallbacks

Fallback concepts

- Fallback language relates to provisions that apply if the underlying reference rate (i.e. LIBOR) in a financial instrument or contract is discontinued or it is not representative. The provisions can be applied **via an Amendment or Hardwired Approach and can be triggered via cessation, pre-cessation and anticipated triggers**
- Regulators, industry working groups and associations recommend that **new production includes robust fallback clauses**
- Market standards for fallback language are already available for main cahs products(ARRC/LSTA and LMA). Although there are certain differences between ARRC/LSTA and LMA recommendations
- BAFT examined the IBOR Transition impact on Trade Finance related products and provided recommendations for each product type

	ARRC Hardwired Fallbacks	LMA Hardwired Fallbacks	BAFT – Recommendations
Objective	ARRC has published LIBOR USD hardwired fallbacks for bilateral loans during 3Q20. The LSTA published a SOFR concept credit agreement following ARRC directions	LMA has published draft fallbacks for multicurrency loans and RCF following UK Sterling WG recommendations	BAFT published a document "SOFR: Trade Finance Priorities" which examines the impact of the LIBOR Transition on the trade finance and payments businesses and which provides general recommendations on solutions for each product type
Approach (Adjusted reference rate waterfall)*	Step 1: **Term SOFR** Step 2: **Daily Simple SOFR in arrears with lookback** Alternatives to step 2: • Daily Compounded SOFR in arrears with lookback • Compound SOFR in advance Step 3: Selected Rate (Lender - if bilateral, or Borrower and Administrative Agent if syndicated)	Step 1: **Daily compound SOFR in arrears with lookback**** Step 2: Compound Central bank rate Step 3: Cost of funds (optional)	Recommendations on discount products are the following: • Forward looking interest rate required for trade finance products • The upfront discounting at the beginning of the period mechanism is what differentiates the product from other trade finance products with loan-like characteristics that has interest accumulating at the end of period. *Working Groups on Risk-free Rates have published in July 2021 their recommendations on the use of term rates. ARRC best practices for the use of the SOFR term rates.*
Credit adjustment Spread	Step 1 and 2: ISDA Credit Adjustment Spread (published by Refinitiv; this is the same as the one published by Bloomberg) Step 3: Selected Spread adjustment (Lender - if bilateral, or Borrower and Administrative Agent if syndicated)	Step 1:ISDA Credit Adjustment Spread (published by Bloomberg) Step 2: Central Bank Spread	• BAFT states they believe the ISDA Credit Adjustment Spread (published by Bloomberg) could also be applied to trade products • BAFT welcomes any (other) solution that could be leveraged.

** be rounded (not truncated) to 5 (SOFR) decimal points, amounts are rounded to 2 decimal points*
*** Use of Central Bank rate + spread in case RFR is temporarily unavailable*

Trigger events

1. **Permanent Cessation:** Regulator announces that the administrator has or **will cease** to provide the benchmark, and there is no successor
2. **Pre-Cessation:** Regulator with authority over the administrator of the benchmark officially announces that the benchmark is **no longer representative**
3. **Anticipated Triggers:** Anticipated triggers are triggers that can be initiated via contractual arrangements:

3.1 Early opt-in (defined by the **ARRC**), which can be initiated by:
A notification by the Agent that at least [five] outstanding U.S. facilities contain (as a result of amendment or as originally executed) a SOFR-based rate as a benchmark rate the joint election by the Agent and the Borrower to trigger a fallback from USD LIBOR and the written notice of such election to the Lenders. The lenders have five business days to object to the "early opt-in" election

3.2 Backstop date (defined by the **LMA**), which can be initiated by a deadline put in place so that once all the conditions of a given contract have been fulfilled the rate switch will occur automatically. This backstop date can be moved if agreed by the requisite parties

04 – External links

Please find below an overview of some key links to external resources and documents which you can access for more information on the IBOR Transition:

Jurisdiction	Risk-free Rates Working Groups	Link to websites/docs
UK	**Working Group on Sterling Risk- Free Reference Rates**	Link
	Statement on behalf of the Working Group on Sterling Risk-Free Reference Rates – Recommendations for SONIA Loan Market Conventions	Link
	Working Group on Sterling Risk-Free Rates Detailed Loans Conventions	Link
	Use Cases of Benchmark Rates: Compounded in Arrears, Term Rate and Further Alternatives	Link
US	**Alternative Reference Rates Committee (ARRC)**	Link
	Summary of the ARRC's Fallback Recommendations	Link
	ARRC hardwired recommended fallback language for syndicated loans	Link
	ARRC Supplemental recommendations of hardwired fallback language for Libor syndicated and bilateral business loans	Link
	SOFR "In Arrears" Conventions for Syndicated Business Loans"	Link
	SOFR "In Arrears" Conventions for Use in Bilateral Business Loans	Link
	Forward Looking Term SOFR and SOFR Averages (Applied in Advance) Conventions for Syndicated and Bilateral Business Loans	Link
	A User's Guide to SOFR	Link
SWITZERLAND	**Swiss National Bank – National Working Group on Swiss Franc Reference Rates**	Link
EU	**Working Group on euro risk-free rates**	Link
JAPAN	**Bank of Japan – Study Group on Risk Free Rates**	Link

Abbreviation	Supranational entities and relevant organizations	Link to websites/docs
ECB	Banking Supervision ECB – European Central Bank	Link
FCA	FCA – Financial Conduct Authority	Link
FSB	FSB – Financial Stability Board	Link
ISDA	ISDA – International Swaps and Derivatives Association	Link
	ISDA 2020 IBOR Fallbacks Supplement	Link
	ISDA 2020 IBOR Fallbacks Protocol	Link
	ISDA 2020 IBOR Fallbacks Protocol (IBOR Fallbacks Protocol) FAQs	Link
	RFR Conventions and IBOR Fallbacks Product Table	Link
LMA	LMA – Loan Market Association	Link
BAFT	BAFT – The Bankers Association for Finance and Trade	Link
	SOFR: Trade Finance Priorities	Link
LSTA	LSTA – Loan Syndications and Trading Association	Link