

# FINMA Guidance 10/2020

## LIBOR transition roadmap

4 December 2020

## 1 Introduction

On 18 November 2020<sup>1</sup> the ICE Benchmark Administration (IBA) as the administrator of LIBOR announced it will consult on its intention to cease the publication of LIBOR in Swiss francs (CHF), euros (EUR), British pounds (GBP) and Japanese yen (JPY) at end-2021. According to information published by the UK's Financial Conduct Authority (FCA) on 18 November 2020<sup>2</sup>, it is unlikely that the conditions required by the FCA for the use of its proposed new powers<sup>3</sup> under the UK Benchmarks Regulation will be met for CHF and EUR LIBOR after the end of the relevant LIBOR panels.

By contrast, for GBP (and with low probability JPY) LIBOR it is probable, but not certain, that the conditions will be met for individual currency-tenor settings and that a synthetic LIBOR for "tough legacy" contracts<sup>4</sup> could be made available for a limited period after end-2021. Regarding the US Dollar (USD) LIBOR, on 30 November<sup>5</sup> 2020 IBA announced that it will consult on its intention to cease the publication of the 1-week (1W) and 2-month (2M) tenors at end-2021 and of the remaining USD LIBOR tenors at the end of June 2023. This announcement was supported by a parallel communication from the FCA<sup>6</sup>, as well as a joint communication<sup>7</sup> by the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC). US authorities encourage banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by 31 December 2021.

And so there remains only a short period of time until the proposed discontinuation of many LIBOR rates and their replacement by alternative reference rates (ARR) such as SARON. On 16 October 2020 the Financial Stability Board published a global roadmap setting out a timetable of actions to be taken in order to enable a smooth and timely transition. The purpose of this guidance is to clarify FINMA's recommendations to the affected supervised institutions and market participants, to ensure that they use the remaining time until the end of 2021 to prepare for a discontinuation of

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<sup>1</sup> <https://ir.theice.com/press/news-details/2020/ICE-Benchmark-Administration-to-Consult-On-Its-Intention-to-Cease-the-Publication-of-GBP-EUR-CHF-and-JPY-LIBOR/default.aspx>

<sup>2</sup> <https://www.fca.org.uk/news/statements/fca-consults-on-new-benchmark-powers>

<sup>3</sup> The *UK Financial Services Bill*, which was introduced to the British Parliament and is being enacted, equips the FCA with new and enhanced powers to change the method used to calculate LIBOR and to extend its publication for a limited time period. The intention of this is to provide a "synthetic LIBOR" for "tough legacy" contracts after end-2021.

<sup>4</sup> "Tough legacy" contracts are contracts without legally and operationally robust fallback clauses or written agreement regarding an ARR.

<sup>5</sup> <https://ir.theice.com/press/news-details/2020/ICE-Benchmark-Administration-to-Consult-on-Its-Intention-to-Cease-the-Publication-of-One-Week-and-Two-Month-USD-LIBOR-Settings-at-End-December-2021-and-the-Remaining-USD-LIBOR-Settings-at-End-June-2023/default.aspx>

<sup>6</sup> <https://www.fca.org.uk/news/statements/fca-response-iba-proposed-consultation-intention-cess-us-dollar-libor>

<sup>7</sup> <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201130a.htm>

LIBOR in CHF, EUR, GBP and JPY (in all tenors), and in USD (in the 1W and 2M tenors) across all product types.

Important successes have already been achieved in the replacement of LIBOR. In October 2020 the International Swaps and Derivatives Association (ISDA) provided an industry-wide solution for most derivatives contracts with its fallback documents. These documents have since been signed by more than 45 Swiss companies. The Swiss Bankers Association (SBA) has also published a corresponding amendment agreement for its Swiss Master Agreement for OTC Derivative Instruments. Several banks have successfully launched SARON mortgages and the National Working Group on Swiss Franc Reference Rates (NWG) has prepared and communicated guidance for replacing CHF LIBOR with SARON<sup>8</sup>. However, by mid-2020 FINMA had not yet noticed any significant reduction in the LIBOR-based contract volume, but had in fact detected an increase.

FINMA still considers the end of LIBOR as one of the principal operational risks facing its supervised institutions<sup>9</sup>. During the meeting of the NWG held on 7 May 2020, it therefore communicated recommendations to the supervised institutions for the year 2020<sup>10</sup>. These were followed by the recommendations on LIBOR replacement for derivatives communicated in Guidance 08/2020.

## **2 FINMA's recommendations and transition roadmap for 2021: the time to act is now**

FINMA recommends that the supervised institutions follow the transition roadmap as set out below in order to be fully prepared for a discontinuation of LIBOR in CHF, EUR, GBP and JPY, as well as USD (in the 1W and 2M tenors) by end-2021.

Brief overview:

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<sup>8</sup> [https://www.snb.ch/en/for/finmkt/finmkt\\_benchm/id/finmkt\\_NWG\\_documents](https://www.snb.ch/en/for/finmkt/finmkt_benchm/id/finmkt_NWG_documents).

<sup>9</sup> Guidance 03/2018 *LIBOR: risks of potential replacement*, FINMA Risk Monitor 2019, Guidance 08/2020: *LIBOR replacement for derivatives*, and FINMA Risk Monitor 2020

<sup>10</sup> Where these recommendations have not yet been implemented, this should be done without further delay (pages 18-19 in [https://www.snb.ch/n/mmr/reference/minutes\\_20200507/source/minutes\\_20200507.n.pdf](https://www.snb.ch/n/mmr/reference/minutes_20200507/source/minutes_20200507.n.pdf))

- **By 25 January 2021:**
  - Signing of *ISDA 2020 IBOR Fallbacks Protocol*\*
- **By 31 January 2021:**
  - No new “tough legacy”
  - Readiness to grant loans based on ARR
- **By 31 March 2021:**
  - Plans for the reduction of “tough legacy”
- **By 30 June 2021:**
  - System and process changes implemented
  - Mitigation of risks for remaining “tough legacy”
  - New contracts in general based on ARR
- **By 31 December 2021:**
  - Full operational readiness
  - All new contracts based on ARR
- **31 December 2021: intended discontinuation of LIBOR\*\***

\* According to Guidance 08/2020: *LIBOR replacement for derivatives*

\*\* Except for individual tenors of USD LIBOR that may continue to be available until the end of June 2023

In concrete terms this means the following:

**By 25 January 2021:**

- **Signing of *ISDA 2020 IBOR Fallbacks Protocol*:** The affected supervised institutions should have signed the *ISDA 2020 IBOR Fallbacks Protocol*<sup>11</sup>. Further recommendations on LIBOR replacement for derivatives are given in Guidance 08/2020.

**By 31 January 2021:**

- **No new “tough legacy”:** Across all product types, there should be no new transactions based on CHF or EUR LIBOR that mature after end-2021 and do not contain robust fallback clauses. Where possible, the same objective should also be aimed at for new transactions based on GBP, JPY or USD LIBOR.
- **Readiness to grant loans based on ARR:** If they are lenders, the affected supervised institutions should be in a position to grant loans that are not based on CHF, EUR, GBP, JPY or USD LIBOR. This can be achieved by giving borrowers the possibility to choose another rate (fixed interest and/or an ARR such as SARON).

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<sup>11</sup> <https://www.isda.org/protocol/isda-2020-ibor-fallbacks-protocol/adhering-parties>

By **31 March 2021**:

- **Plans for the reduction of “tough legacy”:** Based on a full evaluation of their inventory of existing CHF and EUR LIBOR contracts, the affected supervised institutions should have determined which contracts and what volume are potentially “tough legacy” as they mature after 2021 and do not contain robust fallback clauses. They should have formulated detailed project plans with steps to be taken and progress monitoring in order to reduce this volume of “tough legacy” contracts to a minimum by end-2021.

To achieve this it is recommended that at least initial contact is made with the counterparties of potential “tough legacy” contracts by 31 March 2021 at the latest, so that the process of renegotiation or inserting robust fallback clauses can be launched. This applies for all product types, i.e. not just loans and derivatives<sup>12</sup>. Other solutions (such as a premature termination or sale) are also possible in order to reduce the volume.

This objective also applies for the 1W and 2M tenors of the USD LIBOR as well as those tenors of the GBP and JPY LIBOR for which the FCA has indicated that there will be no synthetic continuation.

In relation to the remaining tenors of LIBOR in GBP, JPY and USD, the affected supervised institutions should nevertheless consider agreeing with their counterparties on a conversion of those contracts to ARR.

By **30 June 2021**:

- **System and process changes implemented:** The affected supervised institutions should have implemented the system and process changes necessary to enable transition to ARR and the application of fallback rates.
- **Mitigation of risks for remaining “tough legacy”:** By implementing the plans set out above for the reduction of “tough legacy” and in particular by considering the progress of negotiations already conducted with the counterparties or other solutions that are already in place, it should be clear whether the objective of reducing the volume of “tough legacy” contracts in CHF and EUR LIBOR and the discontinued GBP and JPY LIBOR tenors, as well as the 1W and 2M tenors of USD LIBOR, to a minimum is achievable. For all contracts for which no solution is forthcoming, a risk assessment should be available per contract or product and specific measures should be taken to mitigate these risks. Particularly relevant questions include how likely a legal

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<sup>12</sup> For example, capital instruments, floating rate notes and securitisations, even if the affected supervised institutions themselves are not the issuing party.

dispute is, how the case might play out in court, and what consequences there are for the bank's internal valuation of contracts.

- **New contracts in general based on ARR:** In general, the affected supervised institutions should only use ARR in new CHF, EUR, GBP, JPY and USD contracts.

By **31 December 2021**:

- **Full operational readiness:** All relevant systems and processes should already be able to function without reliance on LIBOR.
- **All new contracts based on ARR:** All new transactions with variable interest in CHF, EUR, GBP, JPY and USD<sup>13</sup> should be based on ARR.

### 3 FINMA supervisory plan for 2021

FINMA will continue to closely monitor the development of the contract volume linked to LIBOR in 2021. In particular, the progress made by the most affected supervised institutions towards minimising the impact of LIBOR replacement will be assessed<sup>14</sup>.

FINMA will continue to gather information on a regular basis on the development of existing and new LIBOR-based engagements as well as on the handling of "tough legacy" contracts.

Where necessary, it will take institution-specific measures to limit the risks<sup>15</sup> of inadequate preparation for the replacement of LIBOR.

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<sup>13</sup> In the joint communication from the FRB, FDIC and OCC, the agencies recognise that, if the administrator of LIBOR extends the publication of USD LIBOR beyond 31 December 2021, there may be limited circumstances when it would be appropriate for a bank to enter into new USD LIBOR contracts after 31 December 2021; refer to footnote 7.

<sup>14</sup> In addition, FINMA is planning work on the yield curves in the Swiss Solvency Test (SST). The Swiss franc yield curve in the SST is already based on Swiss government bonds. Thus there is no LIBOR dependency here. By contrast, the yield curves provided by FINMA for the euro, British pound and US dollar are based on LIBOR rates that are adjusted according to the credit risk. FINMA sees various options here for a transition after end-2021. The decision between these options will be taken in spring 2021.

<sup>15</sup> See also Guidance 03/2018: *LIBOR: risks of potential replacement*.