TXF INTELLIGENCE RESEARCH

No more Libor: What next for trade finance?

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Foreword

This survey of banks and corporates looks at the impact of the London Interbank Offered Rate (LIBOR) cessation for trade finance during a critical inflection point in the path to transition to alternative rates. Progress toward the demise of LIBOR accelerated during the second quarter of 2021. After years of preparation for the cessation, there is now a clear time frame to transition away from the rate that has long been the default benchmark interest rate for trade finance. The findings in this report showcase that the uncertain availability of term rates across currencies remains an acute challenge for banks, but even without a clear solution in hand, communicating with affected customers and third parties throughout the process is critical and must accelerate.

While USD LIBOR is the most widely used benchmark across the trade finance industry globally, the transition of GBP and other LIBOR currencies will also impact the trade finance business. Trade finance products broadly reference LIBOR term rates due to their transparency of pricing and certainty of funding costs. This element is critical, especially for financing offered at a discount, where the value of the discount needs to be determined at the start of the transaction – a case that BAFT has made to regulatory authorities in the U.S. and UK. Progress toward producing a forward-looking term rate has been made in some currencies, such as GBP, but the divergent timelines and approaches across jurisdictions pose a challenge. It is important to continue to monitor progress in the endorsement of the SOFR forward-looking term rate, and to evaluate the viability of other USD benchmark alternatives.

The findings from this study outline the roadmap for how to approach the transition over the next six months. It is important for banks to continue to track currency-specific transition deadlines, intensify internal system and process preparations, and enhance and tailor communication with corporate clients. Taken together, these steps will help to ease some of the uncertainty and pave a more solid path toward transition.

Diana Rodriguez,
Vice President, International Policy, BAFT

With little over 6 months remaining until many Libors cease publication, this survey lays bare the size of the challenge facing the trade finance industry. The pace of announcements in Libor transition can seem overwhelming but developments during the course of the survey period show reasons for optimism. Derivatives contracts dominate the total value of exposures to Libor in financial products and, perhaps understandably, financial regulators tasked with maintaining the stability of the financial system have focussed on addressing Libor transition in the derivatives markets. This has, to a large degree, now been achieved by the widespread adoption by market participants of the International Securities and Derivatives Association (ISDA) IBOR Fallbacks Protocol (which imposes a switch from a Libor to the applicable near risk-free rate upon Libor cessation). It has long been understood that there are more hurdles to transition in cash markets in general and trade finance in particular. It is essential that attention is given by regulators and market participants to this important issue; trade finance is vital to ensuring the wheels of the real world economy keep turning. Corporates (and banks) have had a lot thrown at them over the last few years, negotiating unexpected (Covid-19) and thorny (Brexit) issues but Libor transition deserves considered thought and engagement with its real financial, accounting, taxation and operational impacts.

We have seen client enquiries on Libor transition increase since the start of 2021 and accelerate more sharply since the UK Financial Conduct Authority's (FCA) 5 March 2021 formal announcement of the end dates for Libor. Many have a simple question "What should we be doing?" It is understandable that replacing a simple forward-looking term rate used universally across the finance world with structurally and economically different alternative rates leaves market participants with uncertainty. There has been nervousness around being a first mover; in truth, market consensus is emerging for most Libor currencies, although not, as yet, for US dollars which represents a large part of the trade finance world. There is acknowledgement that many types of trade finance represent "special use" cases for which an interest rate must be known and set at the beginning of an interest period. There are a number of ways that can be achieved including use of a fixed rate, central bank rate, "last reset" compounded risk-free rate or a forward-looking risk-free rate term rate. The latter has been favoured by trade finance participants. Libor's home jurisdiction has shown that it is possible to develop useable forward-looking term risk-free rates (with two providers of Term SONIA publishing such rates since January 2021). All the pieces are now in place for Term SOFR (for US dollars) save that the underlying SOFR derivatives markets which underpins the creation of a robust Term SOFR must increase in volume and liquidity. While Term SOFR does not address all the issues posed by Libor transition (notably it still lacks the credit sensitive element of Libor) it operationalises like Libor and reduces the need for IT systems changes. With new use of USD Libor discouraged after the end of 2021, this liquidity needs to develop quickly. Regulatory efforts are being made in the US to assist with this; these are similar to successful initiatives undertaken by the FCA for SONIA derivatives. If it does not, the message from regulators is clear, trade finance must use other alternatives and we have been working with clients to understand what that means in practice.

No doubt banks must first address transition issues and the survey shows great progress has been made in this regard. A particular early challenge for banks has been IT operational readiness to implement risk-free rate based deals; without this they are simply not in a position to offer borrowers deals based on alternative rates. This seems to have improved significantly over the last six months or so. If Term SOFR is available systems change becomes a less important feature of Libor transition; and perhaps this is why the banks in the survey identified term rates as a more important issue than operational readiness. Libor transition has often been regarded as a "bank problem" but banks trade a fine line between educating borrowers who may be less familiar with the issues around Libor transition and providing advice. It is important that corporates and banks engage with each other to come to mutually acceptable solutions to the Libor transition challenge. We are supporting our clients through this transition period where what is now unfamiliar will become increasingly everyday.

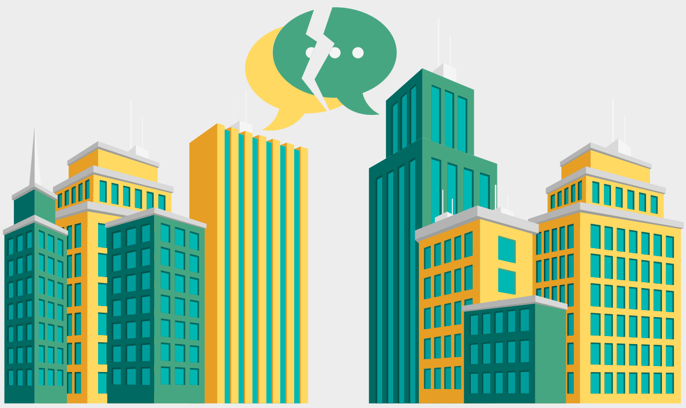
Luka Lightfoot,
Partner, Banking, and finance, Baker McKenzie

Executive summary

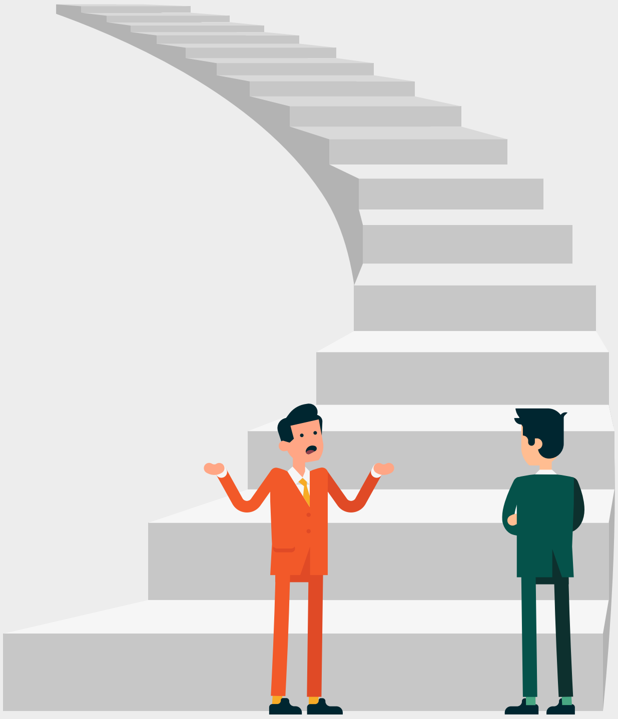
Issues arising from Covid-19 (48%) and from Brexit (25%) were both cited, by corporates, as more important priorities than transitioning all Libor-linked exposures to an alternative RFR. Less than 5% of corporates stated that corporates stated that Libor transition was their top priority.

Nearly 70% of the corporates stated that they do not feel prepared to transition their Libor-linked exposures to an alternative RFR, primarily because a leading term rate has not evolved, and because of the reported lack of support from their banks. Across all of the corporates, just 13% of all Libor-linked exposures have been successfully transitioned to an RFR.

There was a substantial disparity between the perceived level of support on Libor cessation provided by the banks (4.4 out of five) and the perceived level of support received by the corporates (1.9 out of 5).



Three-quarters of the banking sample noted that much more focus is needed on the bilateral and syndicated loans market compared to the derivatives market. The qualitative data suggests that more focus is also needed on different currencies and markets (for example, the Euro and the Japanese yen).



A combined 88% stated that transitioning Libor-linked trade finance exposures to an alternative RFR was difficult. This was reported as a reason why 'very little progress' (1.6 out of five) has been made in successfully transitioning their Libor-linked trade finance-related exposures to a suitable alternative RFR.

The greatest challenges facing the banks when transitioning Libor-linked exposures in trade finance to an alternative RFR were a lack of a forward-looking term rate (76%), a lack of focus on the issue or concerns with other priorities (58%), and a lack of client knowledge on the extent and structure of their exposures (52%).

Introduction

London Inter-Bank Offered Rates, commonly referred to as Libor, are floating benchmark interest rates intended to represent the rate paid by financial institutions when borrowing from each other. It is used extensively across loan and mortgage markets, floating rate capital market notes, securitisations (for example, agency mortgage backed securities), and the interest rate and cross currency derivatives markets.

Libors are intended to represent an approximation of a lender's cost of funding and are based on submissions made by a panel of financial institutions of the interest rate paid when borrowing unsecured funds from other financial institutions.

It is estimated that across these markets, Libor underpins approximately $300 trillion worth of financial contracts worldwide (Bank of England Working Group on Sterling Risk-free Reference Rates, 2018[1]). Consequently, the cessation of Libor is going to have huge ramifications for every Libor-linked exposure. A recent report by Oliver Wyman (2018) titled, ***Changing the world's most important number,*** neatly sums up the size of the challenge.

To understand the size of the task within trade finance, it is important to understand the difference between Libor and risk free reference rates (RFRs) – the alternative rates which have been identified as suitable replacements[2].

Within this research, trade finance is used as an umbrella term that encompasses export finance, commodity trade finance and project finance, as opposed to short term 'traditional' trade finance.

Risk free reference rates

The main argument for moving away from Libor is because it is no longer based on sufficient volume of actual transactions. Following the 2008 Global Financial Crisis (GFC), banks were unwilling to lend to each other, eliminating observable financial transactions and consequently, the ability for the Intercontinental Exchange (ICE), the exchange tasked with collecting and publishing the data, to generate an empirically robust Libor rate.

For instance, the Bank of England estimated that by 2017, there was on average just £187 million worth of three month deposits per day. In comparison, the average value of transactions underpinning Sterling Overnight Index Average (SONIA) is approximately £45 billion (Bank of England RFR Working Group, 2018).

Consequently, as real transactional data dried up that referenced Libor, it became increasingly reliant on 'expert judgement' from the 20 Libor panel banks, a position that was ultimately deemed untenable by many. Consequently, in 2017, the UK Financial Conduct Authority (FCA) announced announced that they would not support the production of Libor after the end of 2021, so paving the way for its discontinuation (Bailey, 2017).

RFRs are mostly unsecured overnight rates[3] based on real and observable transactions from a specific underlying market. One RFR is set to replace each Libor-quoted currency (for example, SOFR for the US dollar, and the Sterling Overnight Index Average (SONIA)), each of which will be based off of live data from their corresponding underling market. RFRs are 'risk free' (or rather near risk-free) because they are based on real transactions (eliminating the risks associated with expert judgments) and based on very short term (overnight) loans (meaning credit and term risk are minimal).

Problem solved… not quite.

The trade finance landscape is complex and contains a myriad of Libor-linked exposures, including bilateral and syndicated loans, supply chain finance loans, pre-export finance contracts, letters of credit, late interest payments, and derivatives to name a few. The difficulties do not just lie in transitioning all of these

[1] Hereafter referred to as the 'Bank of England Working Group'.
[2] This report does not go into how Libor works or why it is being discontinued. For more information on these areas, the Bank of England, Loan Market Association, and UK Finance, have produced a wealth of literature on these topics.
[3] Not all RFRs are unsecured. For example, the Secured Overnight Finance Rate (SOFR) is secured against US treasury bills.

Libor-linked exposures to an alternative RFR (although as this report will show, there are several issues that further complicate matters), but in the liquidity of the underlying market.

A recent report by Morgan Stanley (2019) estimates that the interest swaps and derivatives markets have an estimated value of $200 *trillion*. In comparison, the securitised loans market that references Libor, made up mostly of residential mortgage-backed securities (and therefore not suitable for trade finance cash products), is estimated to be worth less $250 billion. A recent report into global trade finance estimates the trade finance loans market to be approximately $61 billion – 3,270 times smaller than the derivatives market (QY Research, 2020).

This raises the question: If the underlying trade finance market is so comparatively small will sufficient attention be given to addressing the specific needs of this market in Libor transition? One key "need" is useable forward-looking term rates. This means the trade finance market is reliant on the the development of deep and liquid RFR derivatives markets (on which those forward-looking term RFRs are based) which have, especially in SOFR, been slow to take off.

The Libor timer looms large

Despite the major disruption caused by Covid-19, the UK's FCA[4] gave no grace period or delay for the cessation of most Libors. On the 5th March, 2021, the FCA announced that:

- All Euro (EUR), Swiss franc (CHF), Japanese yen (JPY), and pound sterling (GBP) Libor publications will cease on December 31st, 2021.
- One, three, and six-month GBP LIBOR and one, three, and six-month JPY LIBOR settings will be unrepresentative immediately after December 31st, 2021.
- One week and two month US dollar (USD) Libor will cease publication on December 31st, 2021.
- Overnight, one, three, six, and twelve month USD Libor rates will continue until June 30th, 2023 (at which point overnight twelve month tenors will cease and one, three and fix month tenors will be unrepresentative)..
- Additionally, many national financial regulators and currency working groups have set interim transition deadlines to encourage smooth transition in advance of these concreate deadlines (Baker McKenzie, 2021).

It is important to state that while five USD tenors will continue to be published until 2023, this is solely for existing legacy loans and **not** for new loans. The Alternative Reference Rate Committee (ARRC), a group of private market participants convened by the Federal Reserve Board of New York (Fed), has told lenders to cease any Libor-linked activity as soon as practically possible, and certainly not past the end of 2021 (ARRC, 2021).

These dates do not leave much time for questions to be answered, particularly for trade finance where progress appears to be slow.

Questions remain...

For corporates, what measures are being taken to transfer any Libor-linked loans over to an appropriate RFR? What are the challenges that they face in transitioning the Libor-linked loans? What, if any, are their views on the banking support they have received? And what is the likelihood that they will transition all of their Libor-linked loans by the appropriate date?

For the banks, what level of support are they providing to their clients? And in what format is this support being delivered? How easy is it for the banks to implement the advice they receive from their Libor transition working group? How important do the banks deem Libor transition to be in comparison to other challenges they currently face (for example, the fallout of Covid-19)? And finally, what challenges are they facing in working with their clients to effectively transition any remaining Libor-linked loans?

[4] The FCA supervise Libor's administrator (ICE) and control Libors for all currencies.

Timing is everything

The Libor landscape is very fluid and changes on an almost monthly basis as the ARRC, the New York Fed and the FCA make announcements. This will likely have had an impact on how the respondents interpreted the survey questions for this report, which makes it important to present ***when*** respondents took part in the survey. Responses were collected between February and May 2021.

Caption 1 shows a cumulative total of when respondents took the survey in relation to key Libor announcements. This is not an exhaustive list of all announcements, but it provides important context when interpreting the survey findings.

Caption 1: The ever changing Libor landscape and when respondents took part

Libor announcement	Date of Libor announcement	Number of responses collected by this data	
		Banks	Corporates
The UK's Financial Conduct Authority (FCA) formally announced the dates for the cessation all Libors	5th March, 2021	14	16
ARRC Announces Refinitiv as Publisher of its Spread Adjustment Rates for Cash Products	17th March, 2021	27	25
ARRC Provides Update on Forward-Looking SOFR Term Rate	23rd March, 2021	29	31
ARRC Releases Supplemental Recommendation of Hardwired Fallback Language for Business Loans	25th March, 2021	31	36
ARRC Announces Key Principles for a Forward-Looking SOFR Term Rate	20th April, 2021	64	44
ARRC Releases Update on its RFP Process for Selecting a Forward-Looking SOFR Term Rate Administrator	21st May, 2021	78	58

This report

Aims and objectives

The aim of this research is to present the latest market trends on the impending cessation of Libor across trade finance. To meet this aim, the following objectives were undertaken:

• A quantitative survey of trade finance banking and corporate respondents with Libor-linked loans across trade finance.

• Qualitative interviews with consenting respondents to explore in greater detail why the quantitative trends might have occurred.

• The inclusion of TXF Data to add further context on closed deal market information.

Methodology

The data in this report was collected using a mixed methods design that included a quantitative component, an online survey, and a qualitative component, follow-up phone and email interviews. Consequently, the data presented in the subsequent sections is an in-depth and detailed exploration of the impact of the cessation of Libor in trade finance (the survey), contextualised why detailed insights on why these trends might have occurred (the interviews).

The survey

An online survey (SurveyMonkey) was used to collect the quantitative data across trade finance. Specific questions were developed for each industry type with respondents only seeing questions that were relevant to their experiences.

To ensure the overarching aims of this research were met, the survey questions were tailored specifically for the different respondent types to respond to. No duplicate data from the same institution were included. If more than one respondent answered from the same institution, the scores were aggregated and then averaged. This approach ensured that every institution was weighted equally.

There are figures throughout the report where the percentages do not total 100%. The reason for this is because they were a 'tick all that apply' style questions. Where applicable, a footnote has been included to aid understanding and interpretation.

A note on sample size

A total of 136 respondents completed the survey. It is important to note that data presented in this reported is from a sample that only represents a very small percentage of the respective industries. Moreover, the cross-sectional[5] nature of the data means that it is only representative of the industry at the time the data was collected.

However, these caveats are common across many pieces of research, and while they must be acknowledged, they do not detract from the conclusions drawn from the data. Moreover, because inferential statistical analysis was not conducted on the data, the sample of 136 respondents was large enough to conduct methodologically robust data analysis and, most importantly, for reliable trends and conclusions to be drawn.

Consequently, this report is not making any assumptions or providing definitive conclusions about the cessation of Libor in trade finance. Instead, the data presented is giving an insight into prevailing sentiments across parts the banking and corporate world on the impact of the cessation of Libor – research which to date, does not exist in the trade finance industry.

The interviews

To explain the quantitative trends, semi-structured interviews were conducted via phone and email with 10 consenting individuals. Participants were identified through a final question on the survey that asked if they wanted to be involved in a follow-up interview.

The topic guide for each respondent was based on their survey responses, ensuring that the interview remained focused. The interviews were conducted between February and May 2021. Telephone interviews were audio recorded and email interviews were kept on an encrypted hard drive. To protect the identity of the respondents, all qualitative data has been anonymised throughout this report.

[5] 'Cross sectional' data refers to data collected at a single point in time. Data collected over multiple time periods is known as longitudinal.

Understanding the interviews

The qualitative quotes used throughout the report are designed provide additional context and insight to the quantitative trends. The quotes have been analysed against a rigorous framework that promotes transparency and detailed comparison across the interviewees.

This ensures that the quotes are not a collection of anecdotes or isolated views, but instead, an accurate representation across the interviewees. Where there are differing views, these are presented independently within the report.

However, it is important to also state that while the quotes are reflective of the overriding sentiment across all of the interviews, they are not intended to be the defining view of the industry on a specific subject.

TXF Intelligence data

The latest closed deal information from TXF Data is included in this report. TXF Data captures approximately 75% of all closed deal information in the export finance industry. These data will add further context and understanding to this report's findings.

Findings

1. Demographics of the respondents

- Understanding of Libor

2. Current status of the banks and corporates

- Corporates need to catch up
- The process of change
    - A lack of clarity on SONIA
    - Confusion over CAS

3. Engagement

- A tough future for tough legacy contracts
- A clear disparity in support

4. An uncertain outlook ahead

5. The banks: In focus

- Kicking the USD Libor can down the road
- Testing times for trade finance

Demographics of the respondents

Of the 136 respondents that took part in the survey, 58% identified as a bank and 42% as a corporate (figure 1). A combined 63% identified as a global head/director (16%) or operating at a senior level (47%) within their organisations (figure 2). Nearly two-thirds of the sample reported having company headquarters within Europe (including Russia), followed by Asia Pacific (17%) and North America (8%) (figure 3).

The two most prevalent currencies in use across the respondents were USD (96%) and EUR (88%), with GBP (35%) the only other currency to be in use by 10% or more of the respondents (figure 4).

Most of the respondents reported working in an organisation that has an international footprint (87%), with just 4% operating on a local scale (within their own country or immediately surrounding countries) (figure 5).

Figure 1: Type of organisation

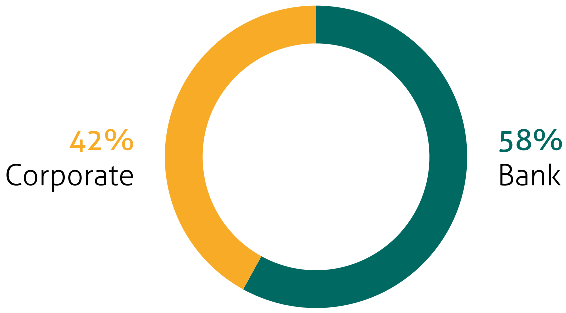


Figure 2: Seniority of respondents' role

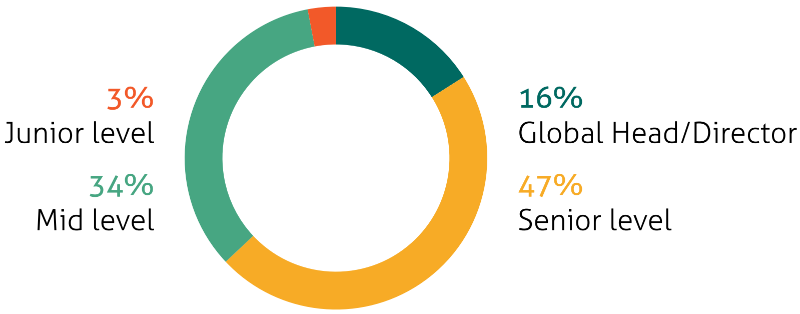
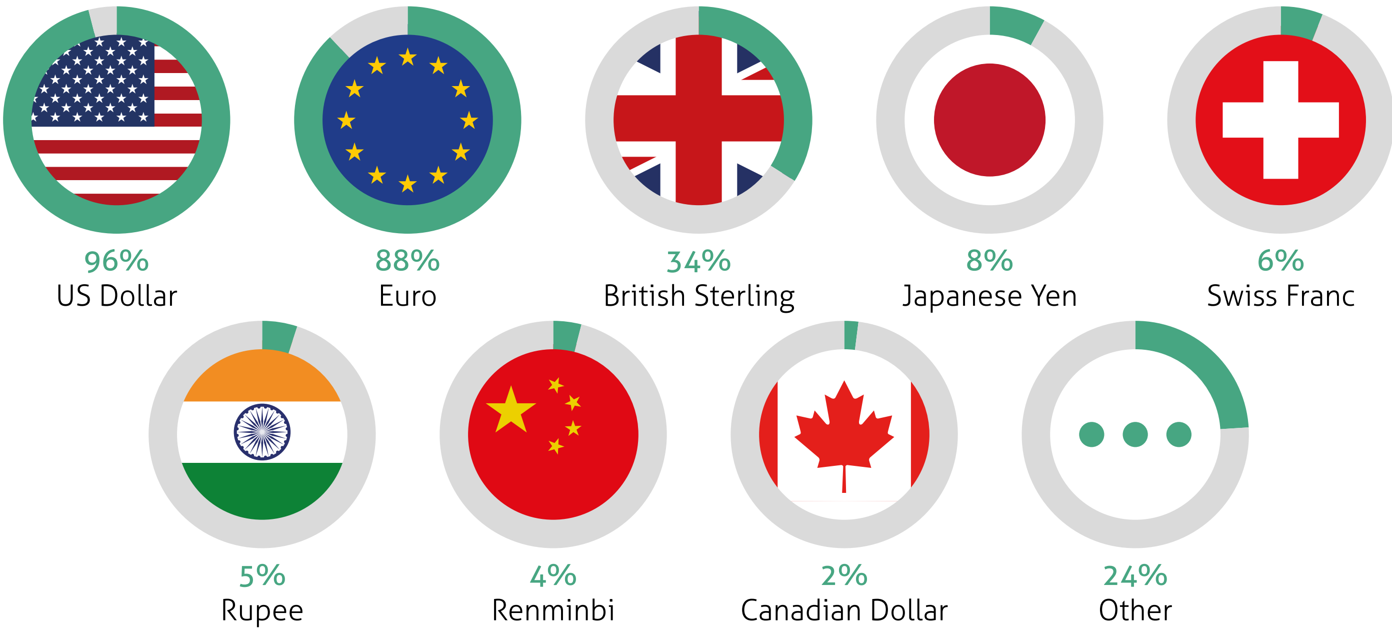


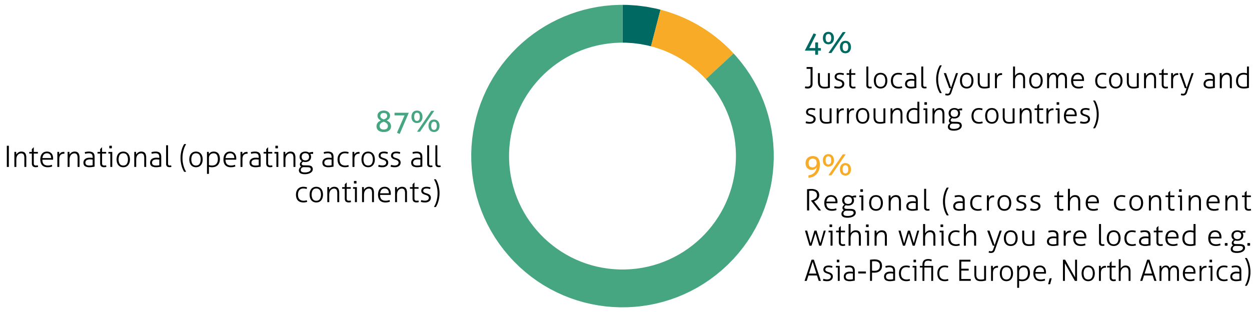
Figure 3: Company headquarters[6]

Figure 4: Most used currencies[7]



[6] The location of the organisation's executive management and key managerial staff.
[7] Tick all that apply question.

Figure 5: Geographic footprint of the respondents' organisations



Understanding of Libor cessation

When the respondents were asked about their current understanding of Libor, the banks were more knowledgeable (3.6 out of five) compared to the corporates (2.1 out of five) (figure 6). This is likely the result of almost all of the banks reportedly having a dedicated working reference group on Libor cessation (see figure 23), and many of the corporates reportedly having other priorities to focus on:

"We know Libor is important and we do have exposure to it within our loans, but honestly, tackling the fallout of Covid-19 is more pressing to us at the moment."
(Corporate; Europe)

It is also important to note that historically, Libor-related discussions have always been a banking issue, with most corporates often following the lead of the banks they engage with. It is only more recently (since the news that Libor is to be discontinued) that corporates have had take a more proactive position in understanding the intricacies of Libor cessation.

In addition to Covid-19-specific issues, Brexit was also reported as being a more important challenge for corporates (figure 7). Just 3% of the corporate sample stated that transitioning Libor exposures to an alternative RFR was their main priority. Whilst corporates with USD and EUR exposures may be forgiven for thinking they have more breathing space (with EURIBOR still available and more widely used for EUR lending than EUR LIBOR for the time being and the most common USD Libor tenors continuing publication until 30 June 2023), the rapidly approaching deadline of December 31st, 2021, for other Libor currencies is a potential cause for concern for the trade finance industry.

US regulators have recommended that no new USD Libor loans are issued after December 31st, 2021, (with the period up to 30 June 2023 being to allow for run off of legacy USD Libor exposures) meaning that corporates could be faced with requests from their lenders within the next six months.

Figure 6: Reported knowledge of Libor cessation

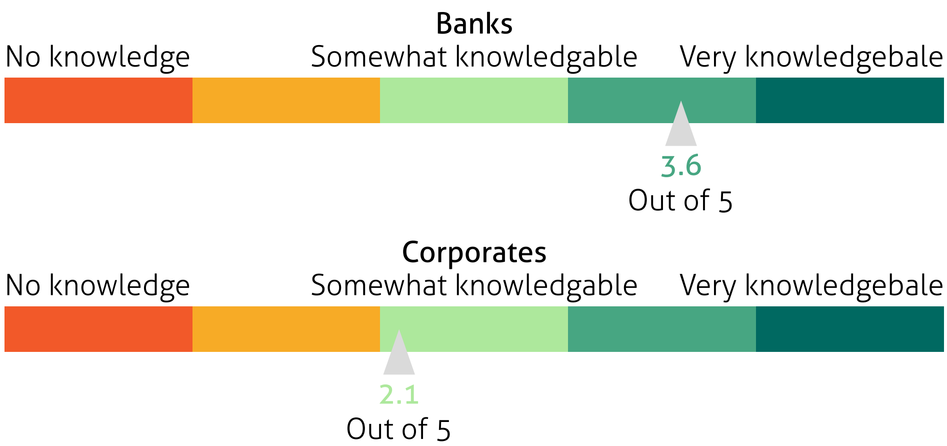
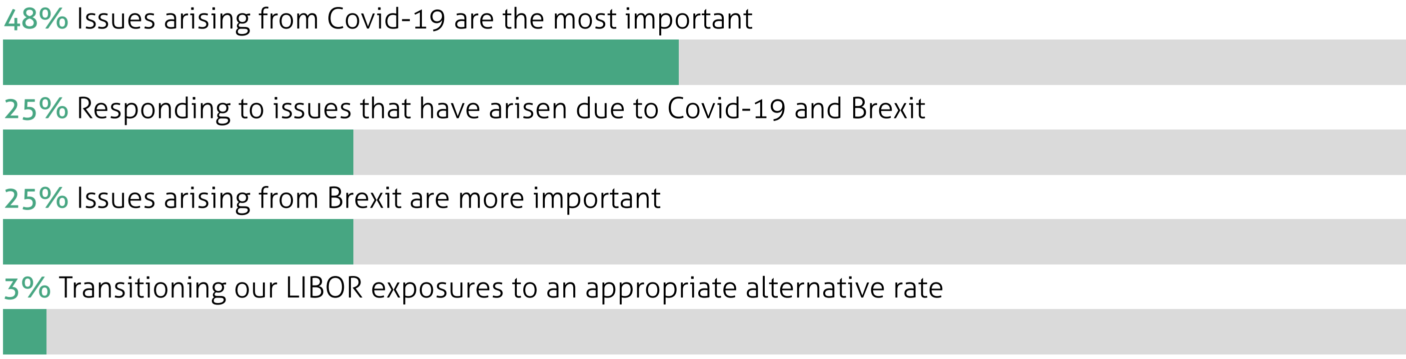


Figure 7: The perceived importance of Libor cessation for corporates



Current status of the banks and corporates

Corporates need to catch up

More than two-thirds of the corporates cited that they are not prepared to successfully transition all their Libor-linked exposures to an alternative RFR by December 31st, 2021, or the June 30th, 2023 deadlines[8] (figure 8). The consequence of this lack of preparedness: Just 13.4% of all Libor-linked exposures across the sample of corporates have been successfully transitioned to an RFR (figure 9)[9]. If any of these Libor-linked exposures are backstop facilities that are yet to be drawn, it is likely that the percentage of exposures that have been successfully transitioned is lower than 13%.

Exploring in more detail where corporates had made progress in transitioning their Libor-linked loans, the derivatives market (36%) was the leading sector. This likely reflects the relative progress that the derivatives market has made compared to trade finance, particularly in the progression of suitable and robust fall back language.

For instance, on January 25th, 2021, ISDA published its IBOR Fallbacks Supplement and IBOR Fallbacks Protocol, a set of amendments to ISDA's standard definitions for interest rate derivatives for mutually adhering counterparties to incorporate fallback provisions into 'relevant IBOR' legacy contracts[10] (ISDA, 2020). While not a 'one-stop solution', ISDA's fallback language is considered robust enough to provide an effective amendment mechanism for the permanent cessation of any relevant IBOR in the future (EY, 2020).

By comparison, progress on fallback language in the bilateral and syndicated loans markets have been slow. At present, most fallback language lacks clarity on the trigger event, only provides a temporary fallback benchmark, and is unclear in selecting replacement rates (EY, 2020). Moreover, the fragmented and diverse nature of the loan market has resulted in less consensus over the calculation of the spread adjustment (which is intended to compensate lenders for the typically lower RFR rate as compared to the corresponding Libor when transitioning a legacy exposure) compared to the derivatives market (Bowie et al., 2020).

Amending loan agreements for Libor transition requires bespoke amendments and the consent of relevant parties (which may include third parties such as export credit agencies) and is more time consuming and complex than for ISDA-based derivatives.

However, it is not just a case of amending loan documents, there are many wider impacts that must be considered, and actions taken, resulting from the different structure of RFRs. These range from

[8] Hereafter referred to as 'the deadline'.
[9] To calculate this rate, each corporate was asked to provide a percentage of how much of their respective Libor-linked exposures have been successfully transitioned to an alternative RFR. The value of 13% reflects the average rate of successful transition across the total sample of corporates surveyed for this research.
[10] Relevant IBORs include LIBOR (with no reference to, or indication of, the currency of such LIBOR), US Dollar LIBOR, UK Sterling LIBOR, Swiss Franc LIBOR, Euro LIBOR, the Euro Interbank Offered Rate, the Japanese Yen LIBOR, the Japanese Yen Tokyo Interbank Offered Rate, the Euroyen Tokyo Interbank Offered Rate, the Australian Bank Bill Swap Rate, the Canadian Dollar Offered Rate, the Hong Kong Interbank Offered Rate, the Singapore Dollar Swap Offer Rate, and the Thai Baht Interest Rate Fixing.

accounting and taxation impacts to ensuring internal IT systems can accommodate the use of RFRs. And one key issue in smoothing some of these other impacts is the ability to use forward-looking term RFRs.

While there was some encouragement that 'some progress' had been made within the trade finance arena, 38%, 32%, and 29% have made 'no/minimal progress' in structured trade/export finance, traditional trade, and supply chain finance, respectively (figure 9).

All of the corporates were clear on why they felt unprepared, namely, a lack of any clarity on a SOFR term rate:

"There is still a lot of uncertainty on what will be the market practice and whether SOFR term rates equivalents will develop ahead of the transition. For corporates who do not have easy access to legal advisors, brokers or the correct bank staff it must be very difficult to get clarity on what is happening and what needs to be done." **(Corporate; Europe)**

Consequently, until a term SOFR is ratified, a lack of preparedness will likely continue and with it, a lack of confidence amongst the corporate survey respondents to transition all their Libor-lined exposures to a suitable RFR (figure 11).

There are some signs of encouragement as the ARRC recently selected CME Group as the administrator of a forward-looking SOFR term rate (ARRC, 2021), but the emergence of AMERIBOR (the American Interbank Offered Rate) and the Bloomberg Short-Term Bank Yield Index (BSBY) have cast doubt on whether SOFR will actually be the predominant replacement for USD Libor.

Figure 8: Corporates' preparedness to transition their Libor loans to a RFR

Figure 9: Percentage of the total corporate Libor exposures that have already been transferred to an alternative RFR

13%

Figure 10: Corporates' progress made in transitioning current Libor-linked loans

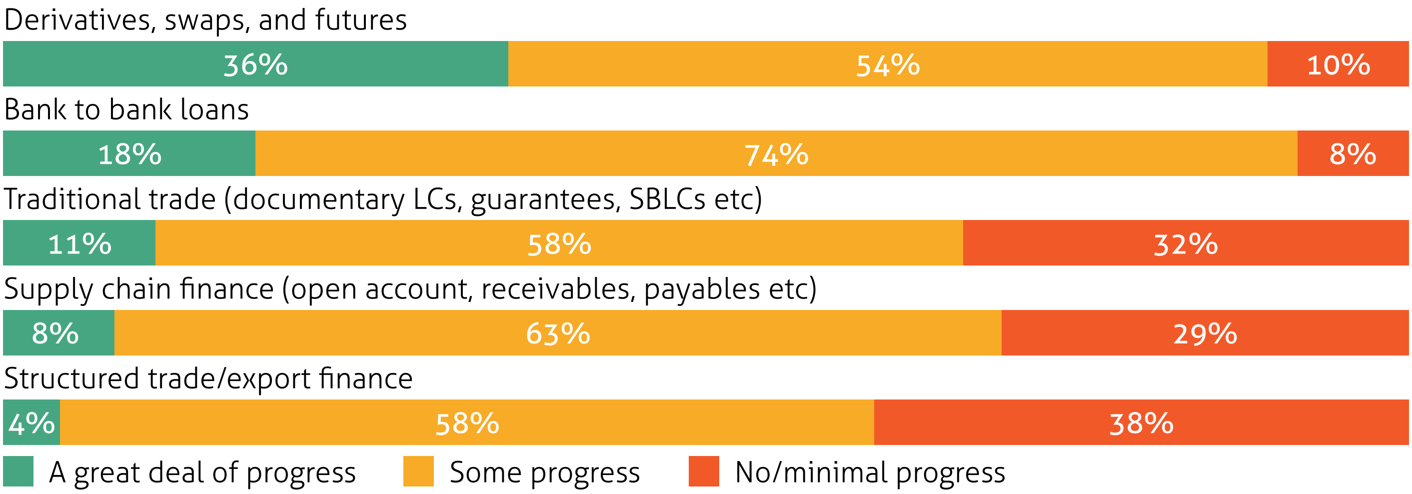
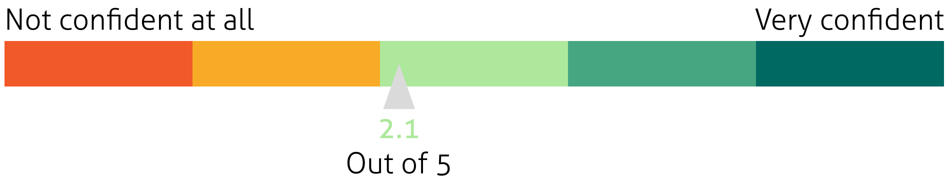


Figure 11: Corporates' confidence that all Libor-linked loans will be successfully transitioned to an alternative RFR



The process of change

When the banks and corporates were asked about the Libor-linked exposures that have been successfully transitioned to an alternative RFR, there was relative synergy between the two respondent types, with an 'automatic switch amendment to a forward-looking term alternative rate' incorporated into existed contracts the most common method (both 46%) (figure 12).

Figure 12: Process for successfully transitioning Libor-lined exposures to an alternative RFR

	Corporates	Banks
Incorporated an automatic switch amendment to a forward-looking term alternative rate (when available)	46%	46%
Incorporated an automatic switch amendment to the appropriate recommended alternative rate on a compounded in arrears or	38%	27%
Refinanced or replaced immediately with the appropriate recommended alternative rate on a compounded in arrears or daily	27%	23%
Refinanced or replaced with a non-alternative rate, such as fixed rate or central bank rate	23%	4%

When the two groups of respondents were asked about their progress in implementing their Libor transition plans, most were 'on track to implement the plan in the time they allocated' (figure 13). Of most concern, was the 36% of corporates and 17% of banks that reported being behind in their transition plans (figure 13).

Figure 13: Corporates' and banks' progress in implementing their Libor transition plan

	Corporates	Banks
We are ahead of where we thought we would be	0%	14%
We are on track to implement the plan in the time we allocated	64%	69%
We are behind where we should be	36%	17%

For the corporates, in addition to the lack of a term SOFR rate, a perceived lack of support from their lenders has made the process of Libor transition all the more challenging:

"Banks have not provided enough information to their customers on this issue. For example, although we work with dozens of different banks, only two or three gave us information on Libor cessation. In addition, the information shared is not precise and comprehensible. In order for corporates to have a plan, a common market practice must be established in the market." **(Corporate; Middle East)**

For the banks, a lack of progress was attributed to two factors: i) a lack of clarity on SOFR, and ii) the credit adjustment spread (CAS) and how the lack of term structure will be considered during times of stress.

i. A lack of clarity on SOFR

"For less sophisticated borrowers, the SOFR with a five day lookback period is simply not going to give clients enough notice for them to settle the relevant interest payments in a timely manner. Many in the export finance market were hoping a term SOFR would be launched in Q3 2021 so clients could work with another 6 month forward rate. However, after last month's announcement by the ARRC, it is not going to happen in 2021 and the likelihood thereafter of it happening is not strong either. There is no industry consensus yet on what is the best alternative solution(s)." **(Bank; Europe)**

The announcement being referred to by the interviewee is that the ARRC will not formally recommend a forward-looking SOFR term rate by mid-2021, primarily because of concerns in the underlying liquidity of the derivatives market (ARRC, 2021).

However, since the ARRC's announcement, CME Group have started publishing live term SOFR rates (for one, three and six month tenors) and the ARRC has chosen them as their recommended provider.

In the meantime, institutions are considering USD credit sensitive alternatives to SOFR, such as the Bloomberg BSBY Rate, the ICE Bank Yield Index, the AMERIBOR Rate or the IHS Markit Rate. As opposed to a term SOFR several of these rates include a credit risk component. Despite this cautiously optimistic step forward, the ARRC has not yet endorsed the rates produced by CME Group, primarily because the liquidity of the underlying SOFR derivatives market must first improve.

At present, this appears an uphill battle, with the ISDA Clarus Adoption Indicator around 7.5% for SOFR derivatives at present. It is worth noting that term SONIA and the Toyko Term Risk Free Rate (TORF) are available and being used in GBP and JPY transactions, respectively.

ii. Confusion over CAS

"There are still a number of issues that need to be resolved around the lack of credit risk within SOFR. Libor contains a built in unsecured bank risk element. By its very nature of being risk free, SOFR does not... in loans and other cash products like residential mortgages, you have to implement a CAS to mitigate the risk of value transfer when transitioning to a risk free rate. Without it, there is no measurement used to offset the difference between Libor and SOFR caused by the lack of a credit risk premium." (Bank; Europe)

During times of relative ease, the differential between the five year lookback for SOFR and Libor for CAS is comparable. However, problems arise during times of stress.

Currently, during times of economic stress, the cost of wholesale funding for banks increases to reflect the increase in risk and the weakness in the banking system. However, the opposite is true for SOFR. Unlike Libor, which is unsecured wholesale funding, SOFR is secured against US Treasury bills. This means that investors tend to move more heavily towards US Treasuries during times of stress as it is considered lower risk. This flight to quality drives down the price of the 'repo rate' market[11].

Consequently, during times of stress Libor rates increase, while at the same time, SOFR rates decrease. This happened during the early stages of Covid-19. The Fed saw SOFR rates move from 80 basis points (bps) to around 5bps, while Libor rates increased from 80bps to 140bps. Concurrently, opportunistic corporate borrowers were motivated to draw down SOFR linked lines of credit and hoard liquidity thereby diverting funds from other businesses. The disconnect between SOFR and LIBOR intensified the desire for a credit-sensitive spread to supplement SOFR (Bloomberg Quantitative Research, 2020).

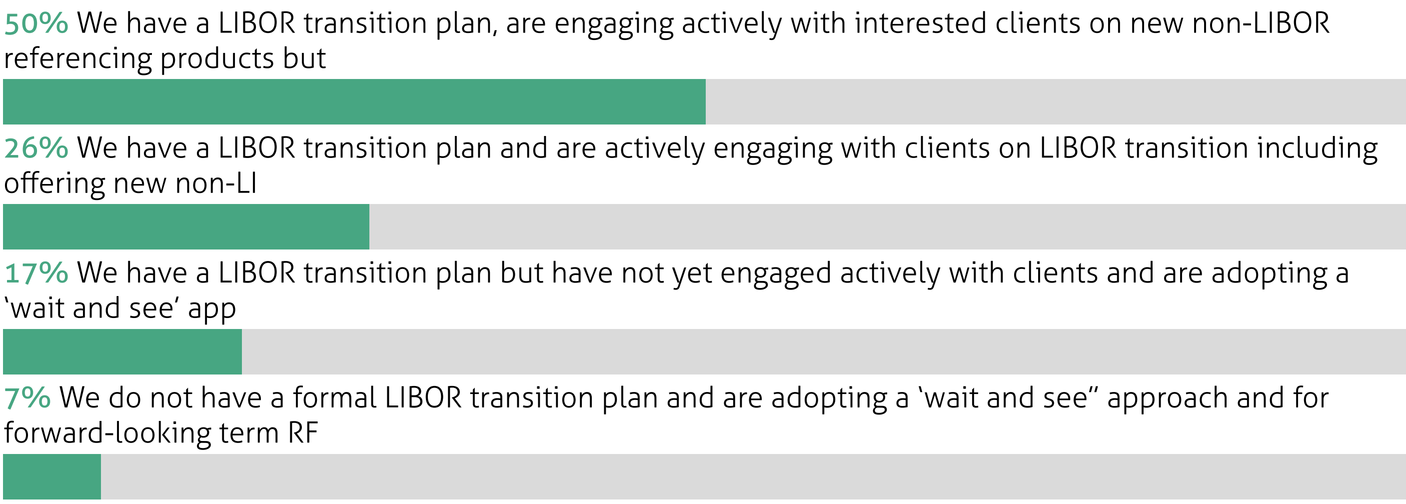
To date, this is yet to happen which, for the trade finance industry, is a significant hurdle as most borrowers will want to know the cost of debt, including CAS, prior to signing the facility agreement.

Engagement

A tough future for tough legacy contracts

Figure 14 demonstrates that the banks have a Libor transition plan in place which they intend to implement with their clients. However, 50% of the banks have not started transitioning legacy contracts, and a further 26% are adopting a 'wait and see' approach based on how the trade finance market unfolds.

Figure 14: Banks' reported protocols in place for transitioning their clients' Libor-linked exposures



[11] US Treasury repurchase market.

A note is needed here on tough legacy contracts as they are possibly the most challenging problem for the trade finance industry. Tough legacy contracts have no clear definition but are generally held to mean existing Libor contracts that are unable to either be converted to a non-Libor rate or to be amended to incorporate appropriate fallback language.

The ISDA IBOR Fallbacks Protocol was seen as a key piece in addressing legacy LIBOR derivatives transactions. Loans and bonds require individual amendment.

For more recent English law facility agreements based on the Loan Market Association's (LMA) templates, *a replacement of screen rate clause* has generally been included to facilitate Libor transition by providing for lower lender consent levels for amendments to contracts, allowing for an easier transition to an alternative benchmark. In 2020, we began to see 'rate switch' agreements in the wider loan market which hardwire in a switch from Libor-based loans to RFR-based loans, without the need for further amendment at the time of the switch. In New York facility agreements, similar moves were made to address the end of Libor. These clauses can include either an amendment approach[12] or a hardwired approach[13], both of which are designed to facilitate transition to an alternative RFR.

Legislative 'solutions' have also been adopted in a number of jurisdictions, including the US, the EU and the UK. Issues remain around the scope of these laws and how these various solutions will interact with each other. The US and EU legislation adopt a similar approach by imposing in relevant contracts a replacement rate.

The UK legislation is somewhat different in that the FCA is empowered to require the continued publication of certain Libors after they continue to be unrepresentative but based on a different methodology. The administrator of Libors (ICE Benchmark Administration (IBA)) is consulting on whether it will continue to publish 'synthetic' versions of one, three and six month GBP Libor and one, three and six month JPY Libor after December 31st, 2021. These synthetic rates will essentially be term SONIA or TORF (plus a credit adjustment spread). They have reserved their position on whether a synthetic USD Libor may be available post June 30th, 2023. However, the ability to use any synthetic Libor is likely to be restricted to certain legacy contracts only (and not for new use).

Where older legacy loan documentation cannot insert suitable fallback language, the ultimate fallback in English law style loan agreements may well be to the individual's cost of funds and in New York law style loan agreements to prime rate.

This is problematic for three reasons:

1. In the bilateral loans market, there is a lack of standardisation of terminology, meaning that there is a wide variance in the fallback language.

2. For many short term bilateral loans, these will have to be amended on a case by case basis.

3. Borrowers in the bilateral market tend to be less sophisticated and, therefore, less aware of Libor cessation.

The issue of borrower sophistication was a point made by several of the banks, as one noted:

"ECA loans are probably 75% into emerging markets. The changes to RFR that have been implemented are not geared to emerging markets. They are geared to the majority of the market in the developed world where borrowers are sophisticated and do not have the constraints that emerging markets have, for instance exchange controls." **(Bank; Europe)**

While the banker offered a glimmer of hope for the export finance market, *"ECA loans market is a small piece of the loans pie and will has special considerations... this is being dealt with"*, the Taskforce set up to tackle tough legacy contracts were less optimistic citing that, *'renegotiation of all these contracts on an individual basis ahead of end 2021 creates practical difficulties for market participants'* **(Bank of England Working Group on Sterling Risk-Free Reference Rates, 2020).**

For trade finance, an industry with billions of dollars of bilateral and syndicated loans, it faces a difficult challenge to successfully transition all these exposures to an alternative RFR.

[12] An amendment mechanism follows the occurrence of a trigger event, which then precipitates a negotiation on the most suitable alternative benchmark to replace Libor.
[13] A hardwired mechanism identifies the replacement rate and allows the agent bank to implement the necessary documentary changes without further reference to the parties upon the occurrence of a trigger event.

A clear disparity in support

The banks and corporates held a broadly similar view on how regularly they are in contact with one another on the topic of Libor cessation (figure 15). Corporates noted that emails (71%), client-specific communications (67%) and a written newsletter (43%) were the most common forms of contact (figure 16).

None of the corporate interviewees were satisfied with the type of communication they have received, with several stating that they have self-educated themselves on Libor cessation:

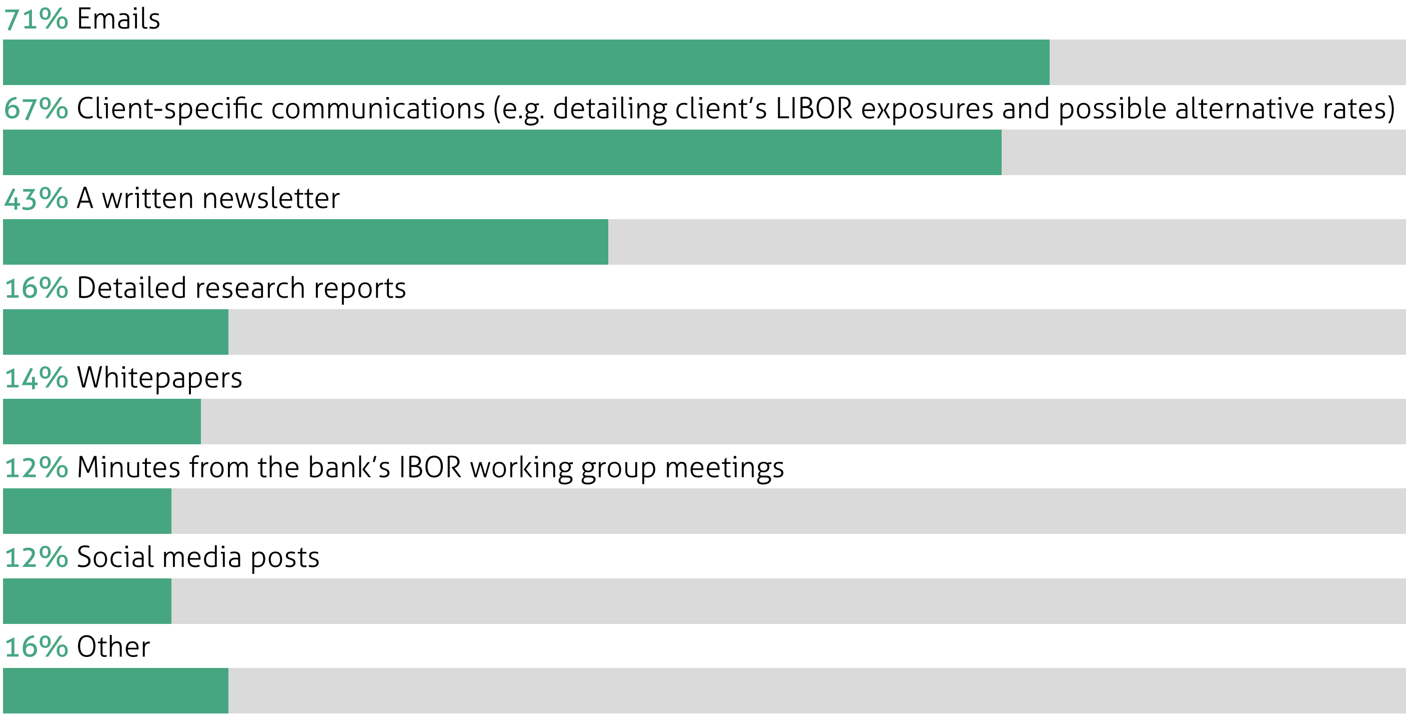
"The type and quality of the support we have received has been poor. I have mainly received general notification e-mail... In the meantime, I have educated myself on Libor cessation. We have performed a scan throughout the company and developed our own route-map. We don't need any support from our lenders anymore." **(Corporate; Europe)**

While these corporates have taken a diligent approach, they are likely in the minority, especially as other extenuating circumstances draw attention away from Libor-related discussion (see figure 7).

Figure 15: Perception on the frequency of communication

	Corporates	Banks
Monthly	33%	26%
Quarterly	30%	25%
Twice a year	15%	21%
Once a year	5%	11%
Less than once a year	10%	9%
We have no communication from our lenders	8%	8%

Figure 16: Libor transition literature provided by the banks to their clients[14]



Perhaps of greater concern, was the disparity in the perceived level of support received by the corporates and provided by the banks. Figure 17 shows that corporates reported little support on the topic of Libor cessation, while the banks perceive themselves to be providing 'a great deal' of support.

One corporate even suggested that the banks have been looking to them for information on Libor:

"The support we received has not been good enough. Front officers generally only have a vague idea of what will happen and sometimes have not even been informed at all (depending on the business they cover). We are generally more informed than the banks are. Many banks are waiting for signs to determine a market trend, but there are not enough banks moving ahead with a firm position to see a market trend. Banks regularly sound us out to know what other banks are doing." **(Corporate; Europe)**

It is important to note that this corporate works in a global trading house and is therefore not representative of the other smaller corporates. Yet the underlying sentiment was reflective of the other corporate respondents. Every corporate interviewed spoke at length about the lack of support they have received from the banks on Libor cessation has been unacceptable, both in terms of the content and frequency of contact they have received.

However, to explore the reported disparity presented in figure 17 in more detail, the banking interviewees were asked to explain why they think this finding has materialised. It subsequently became clear that banks found it difficult to better engage with clients in emerging markets because of the lack of information they have at hand to support them:

"Client engagement has started for GBP denominated business and is now picking up speed for other currencies as well. One difficulty in client conversations on USD is the uncertainty around term rates or other suitable alternatives for emerging clients... Client engagement is important, but we also need to be able to provide clear guidance on different options. The latter is currently still difficult with latest ARRC announcement discouraging Term Rates for emerging market clients." **(Bank; Europe)**

Another banker also highlights the lack of clarity that exists for the EUR or JPY:

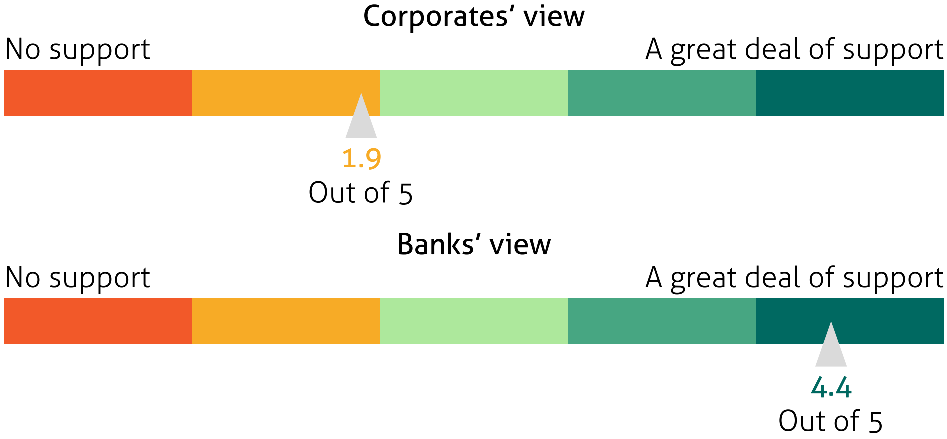
[14] Tick all that apply question.

"For the euro, there is no clarity at all so no proper engagement can happen with clients. Even with the Japanese yen, there is, to my understanding, a difference in what is being offered currently by the Japanese vs international banks." (Bank; Europe)

These sentiments are a fair reflection of the prevailing position of Libor transition. The ARRC have recently delayed recommending a forward-looking SOFR term rate, the emergence of AMERIBOR, BSBY, Fed funds, and the ICE Bank Yield Index, have split attention away from SOFR, there is a lack of clarity on fallback language for the bilateral and syndicated loans market, and as one banker noted, *"the size of the repapering of contracts is unprecedented."*

Consequently, while the banks can do more to engage and support their clients on Libor transition, there are extenuating factors outside of their control that limit the support they provide.

Figure 17: Perception of the level of support received by corporates and provided by the banks



An uncertain outlook ahead

Looking forward, the banks provided a fairly pessimistic outlook. Of those that do not currently offer an alternative RFR to their clients, 46% plan to offer an RFR with suitable fallback language by the end of Q4 2021 (32%) or in 2022 (14%) (figure 18). Given that the deadline for transitioning most Libor-linked exposures over to an alternative RFR is December 31^{st}, 2021, the exception being USD Libor at overnight, one, three, six, and twelve month USD Libor rates will continue until June 30^{th}, 2023, it suggests that the clients of these banks will most likely not meet the deadline.

In the event that banks are unable to meet this deadline, the three most likely solutions were defaulting to an alternative rate such as a central bank rate (43%), assuming the interest on day one of a closely associated RFR and using that throughout the duration of the term length (28%), and only offering loans that use currencies with its own alternative RFR (26%) (figure 19).

Figure 18: Expected quarter for banks that do not currently offer an alternative RFR, to begin offering one to their clients

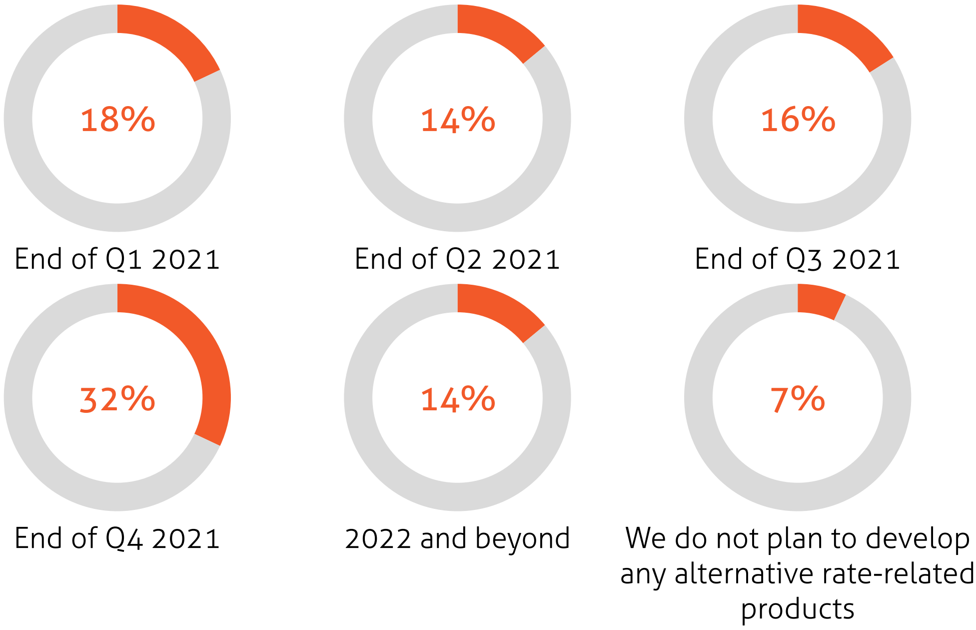


Figure 19: Banks' contingency plans in the event that Libor transition is unsuccessful

Use an alternative base rate (for example, the Bank of England)	43%
Assume the interest on day one of a closely associated alternative rate and use that throughout the term length	28%
Only offer loans that have currencies with its own alternative rate	26%
Only provide products where LIBORs are still available	20%
Use synthetic LIBOR (if available) or other legislative solutions	20%
We will discontinue all IBOR-related products	13%
Other	17%

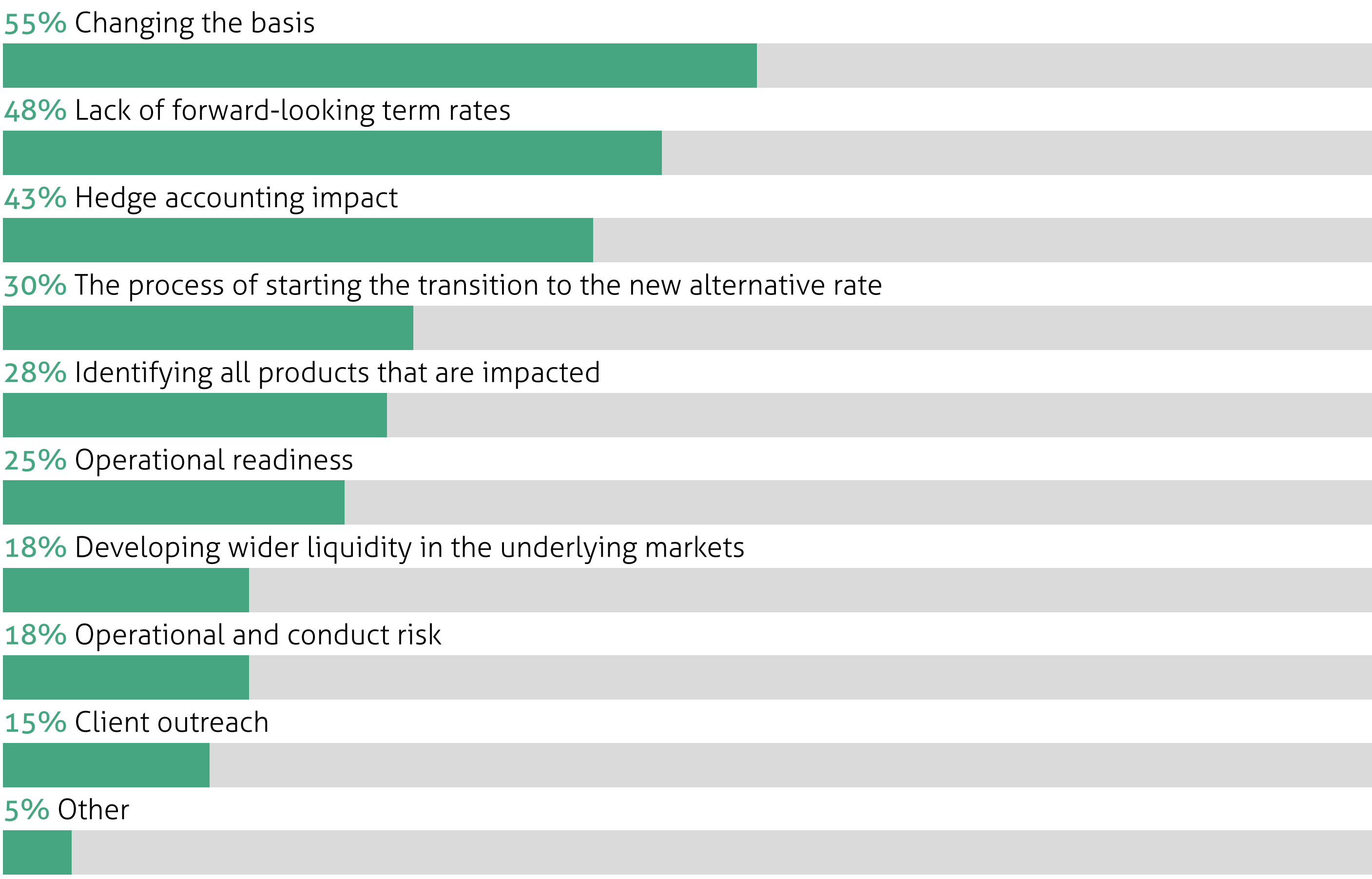
There was a plethora of challenges that the corporates reportedly face when attempting to transition Libor-linked exposures to an alternative RFR, with changing the basis (55%), a lack of a forward looking term rate (48%) and hedge accounting impact (43%) the top three concerns (figure 20).

For the banks, the legal terms of their loans (61%), operational challenges of contacting clients and restructuring contracts (57%) and updating their IT and internal infrastructure (53%) were the three greatest challenges (figure 21). These data highlight the importance of unambiguous fallback language for cash loans and the challenges presented by less sophisticated borrowers in emerging markets.

One banker also pointed to the substantial challenge that lies ahead for the banking industry in terms of changing their internal procedures and architecture:

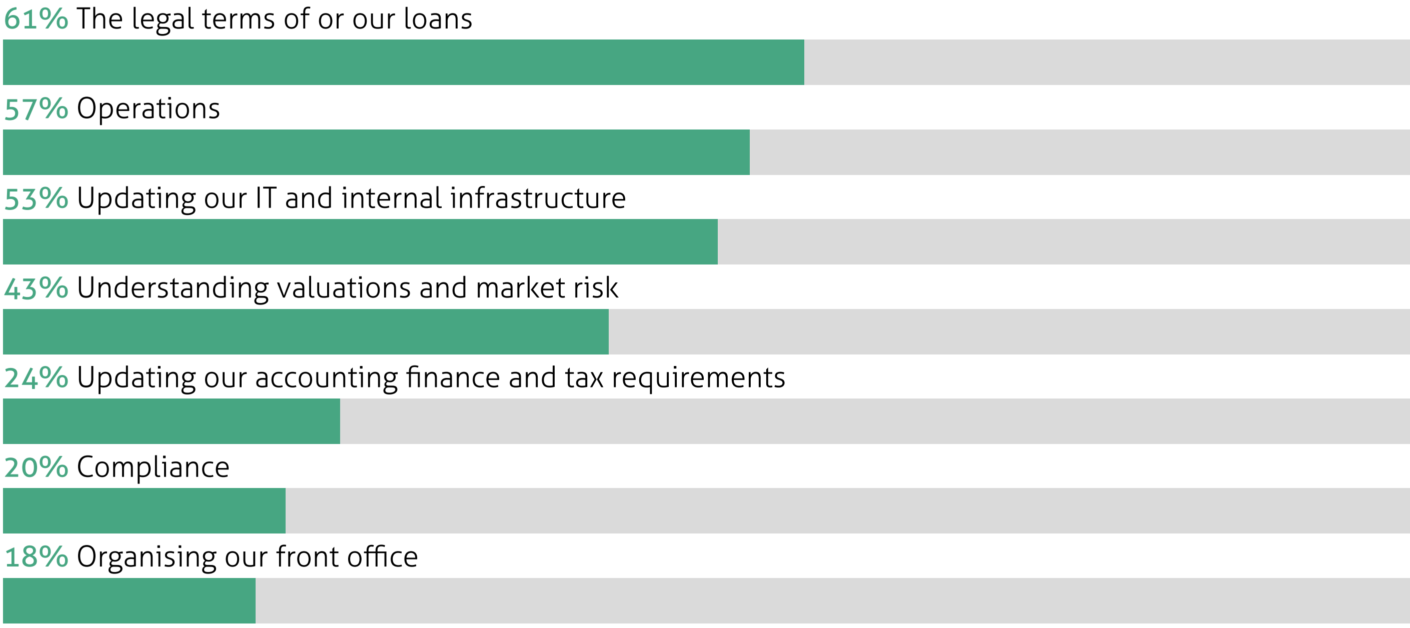
"We have been set up for Libor for 40 years. It is engrained in how we operate. Changing that in such a short time is incredibly challenging... We are having to review our entire IT system and how we digitalise contracts." (Bank; Europe)

Figure 20: Greatest challenges for corporates when transitioning Libor-linked loans to an alternative RFR[15]



[15] Tick all that apply.

Figure 21: Greatest challenges for banks when transitioning Libor-linked loans to an alternative RFR



Three-quarters of the banking sample noted that much more focus is needed on the bilateral and syndicated loans market (figure 22). One banker explored the consequences of failing to do so:

"In certain markets (for example, emerging market sovereigns) and products (discounting, Islamic Financing) there needs to be certainty at the start of the deal and/or at the start of the interest period about the interest that is due. While fixed rate solutions can address this to some extent, some borrowers want a floating rate structure. Without a forward-looking term rate, the particular requirements of these borrowers/ products will be completely overlooked, leading to complications for all parties.

This means interest will be paid late if interest due can only be communicated to clients five days ahead of the interest due date. With administrative processes required, especially in countries with tight currency transfer regulations or sovereign clients as borrowers, a five day notice period will not be sufficient to process interest payment on time. Therefore, there is the possibility of default and more administration around those late payment events." (Bank; Europe)

It has been discussed at length in this report the need for more focus on cash product transactions, principally because they form the majority of contracts in trade finance. However, an important point also raised by the respondent is the need to focus on other markets and currencies.

At present, most of the prevailing literature and working group discussions focuses on SOFR or SONIA; in the former case because the use of USD in loans is widespread globally and represents the greatest volume of trade finance business overall; in the latter case, because GBP is the currency of the 'home jurisdiction' of Libor and regulatory pressure in the UK has resulted in more advanced adoption of SONIA in case markets as compared to other RFRs.

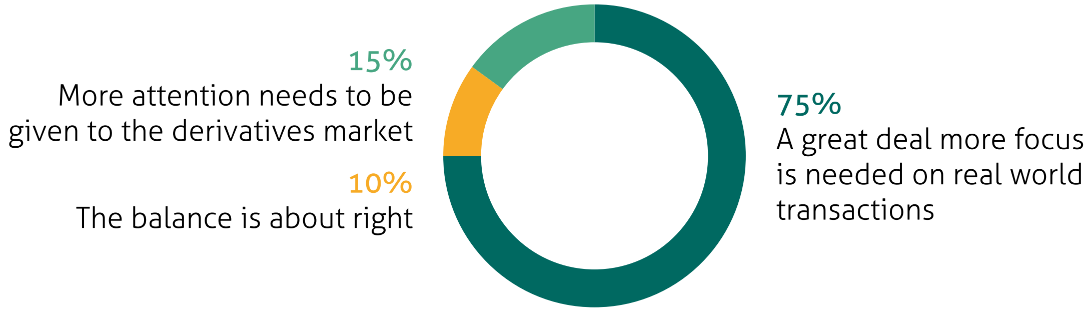
By comparison, the continuing availability of (virtually) like-for-like replacements for EUR and JPY Libors (EURIBOR and TIBOR, respectively) has acted as a disincentive to address transition issues in these markets. Whilst the European Central Bank has recently published its recommendations and guidance in relation to suitable fallbacks rates for EURIBOR, without a clear end date for EURIBOR and clarity on whether a forward-looking €STR-based term rate will be available for use, mean that most in the market remain in 'wait and see' mode.

Transition in JPY lending has been given a boost by both the news that a forward-looking term rate (TORF) is now available for us and that Euroyen TIBOR is likely to be discontinued at the end of 2024. However, there remains a lack of consensus about the Libor replacement for JPY Libor, with JPY TIBOR likely to continue (and be used within the Japanese loan market) and potentially more widespread use of TORF than TONAR in cash markets.

A suitable RFR structure for Islamic financing is also in relative embryonic stages, with regulators facing major challenges to develop a *Shari'ah*-compliant RFR that suitably meets the *Shari'ah* principle of *gharar*, the prohibition of uncertainty or speculation (Al Natoor, 2020). At present, Libor is suitable for Islamic financing as it sets the rate ahead of the interest period. The backward-looking nature of RFRs means that interest is not known ahead of time, thus making them ineligible for Islamic financing.

For export finance and project finance, both subsectors of trade finance where Middle Eastern involvement are increasing, no suitable RFR for Islamic financing is a major challenge that needs addressing.

Figure 22: Reported need for attention on the bilateral and syndicated loans market compared to bank-to-bank derivatives



The banks: In focus

Kicking the USD Libor can down the road

The final two sections are based on banking data only.

More than 50% of the banks reported being involved with multiple Libor dedicated working groups, with the ARRC and the Bank of England RFR Working Group the most common (figure 23). Almost all of the banking respondents noted that there is a dedicated Libor working reference group situated within their banks (figure 24), and that it is relatively straightforward for the banks to implement their working groups recommendations (figure 25). Trade finance was reported as a somewhat important priority for the working groups (figure 26).

Across the banks surveyed, they noted that their working groups are somewhat effective at communicating their findings and recommendations to their customer engagement teams (figure 27). The customer engagement teams will have a key role to play in closing the reported disparity gap that currently exists between the level of support provided by the banks and experienced by the corporates (see figure 17).
However, as several of the banks noted, engaging with clients is a time consuming task and one that is not guaranteed to yield results:

"Of course, it is for the banks to engage with their clients, but the clients have to be proactive. We can provide them guidance and support, but they need to provide us with important information too... this does not always happen which slows the process down and dealing with each client take a huge amount of time and resources on our end... that workload for us [the banks] often gets overlooked." **(Bank; Asia Pacific)**

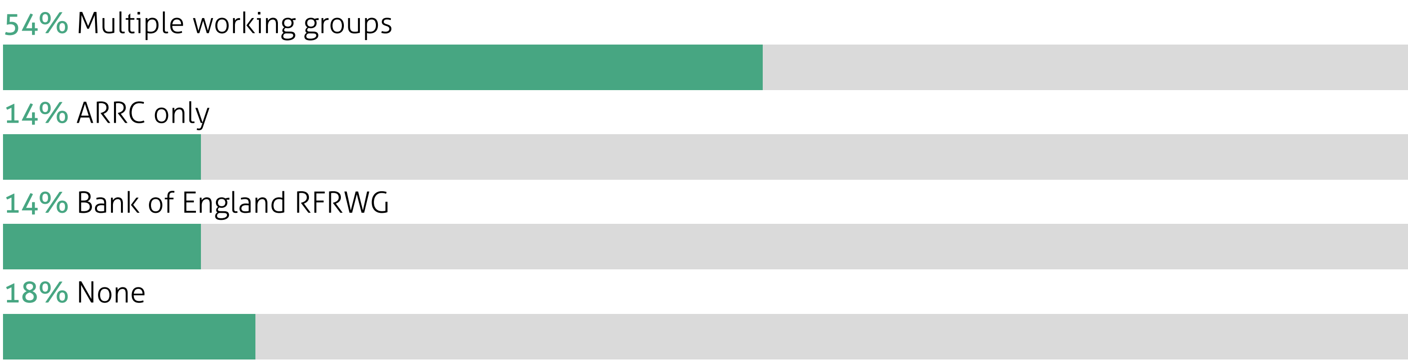
Another banker also cited the bureaucratic challenges that corporates face internally to understand Libor cessation, all of which detrimentally impact the transition to an alternative RFR:

"There has to be education by banks but ultimately (within what is possible technically and allowed by the regulators) clients will need to make decisions. Some are already there but those with more bureaucratic procedures are probably not as well placed on this subject." **(Bank; Europe)**

The greatest problem that underpinned these more practical challenges, however, was the ongoing lack of clarity that on which RFRs are going to be used for each currency. The reported difficulties around SOFR were particularly problematic:
"The banks do need to educate [clients], but most importantly, they need to work out what alternative solutions to a SOFR term rate they can offer. Until this is done, they will not be able to have a meaningful dialogue with their clients." **(Bank; Europe)**

To complicate matters further, the IBA announced at the end of 2020 that USD Libor for overnight, one, three, six and twelve months can continue to be quoted until June 30th, 2023[16] which, one banker noted, *"is just kicking the can further down the road."*

Figure 23: Working groups attended by the banks



[16] This extension only applies to legacy transactions, so all new deals will have to quote an alternative USD rate.

Figure 24: Proportion of banks with a dedicated Libor working reference group

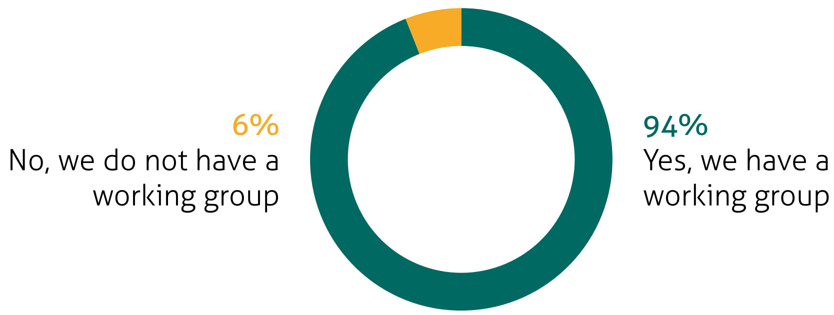


Figure 25: Ease with which banks are able to implement working group recommendations

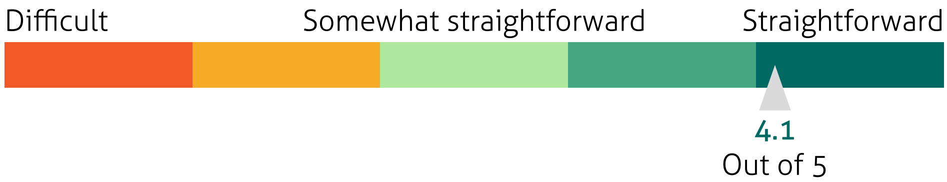


Figure 26: Perceived importance of trade finance to the banks' working reference groups

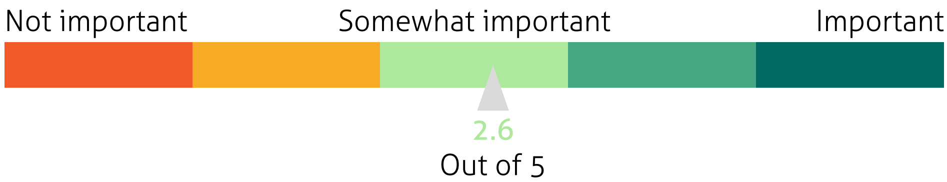
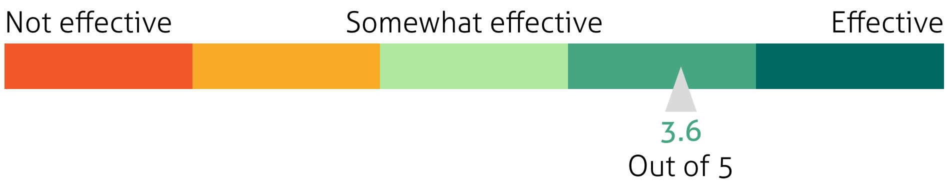


Figure 27: Effectiveness of the Libor working groups to communicate with the bank's customer engagement team



Testing times for trade finance

Across the banks surveyed, a combined 88% stated that transitioning Libor-linked trade finance exposures to an alternative RFR was very difficult (17%) or somewhat difficult (71%) (figure 28). This was reported as a reason why very little progress has been made in successfully transitioning their Libor-linked trade finance-related exposures to a suitable alternative RFR (figure 29).

The banks were clear in stating that a lack of a forward looking term rate, compounded by other priorities, and a lack of knowledge on their clients' internal structures were the greatest challenges they faced when transitioning their libor-linked exposures to an RFR (figure 30).

Figure 28: Perceived difficulty for banks to successfully transition Libor-linked trade finance loans to a suitable alternative RFR

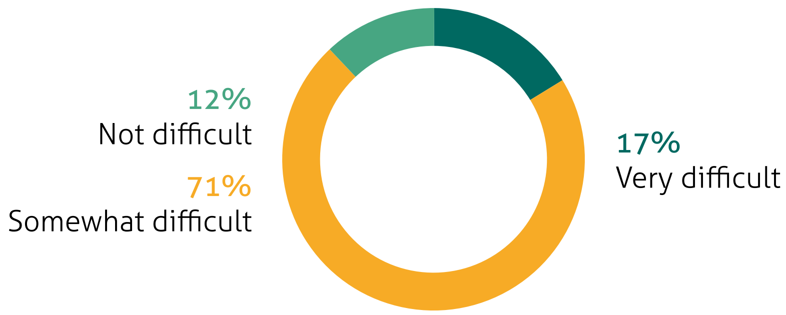


Figure 29: Banks' level of progress in transferring their Libor-linked trade finance exposures to an alternative RFR

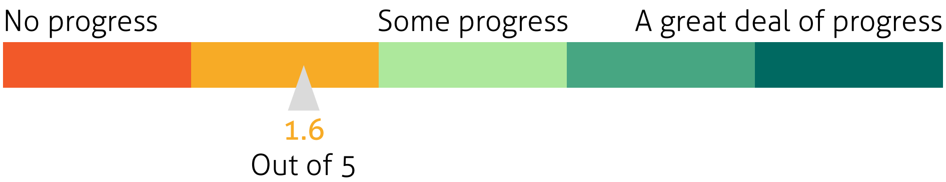
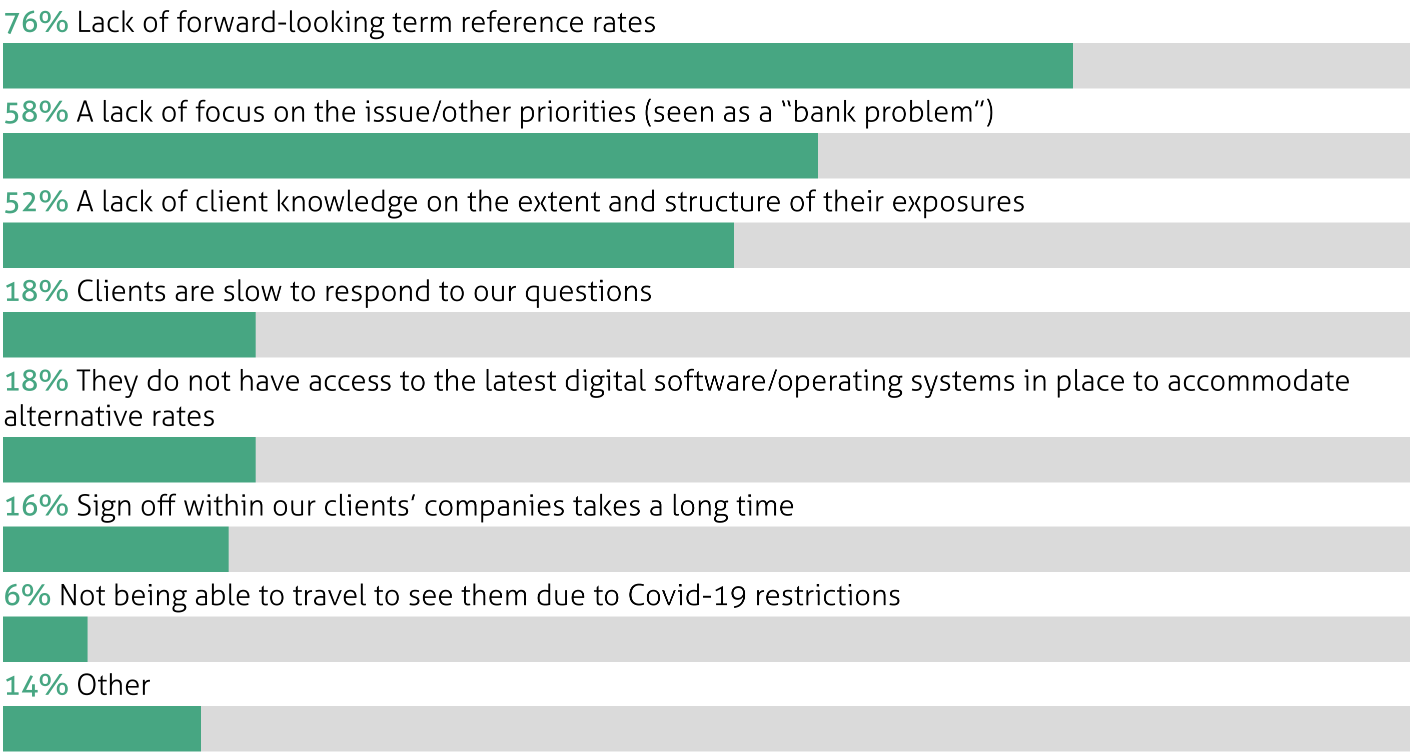


Figure 30: Greatest challenges for the banks working with trade finance clients to transition Libor-linked loans



When the banking interviewees, all of whom are active in export finance, were asked what the cause of the difficulty was, there was a unanimous response that highlighted the challenges around the five-day lookback period:

"For many export finance borrowers, the backwards RFR with a five day lookback period is too restrictive. The [export finance] industry needs to see if a longer look back period could be determined that could work for both the borrowers and the banks." (Bank; Europe)

"ECA loans market is a small piece of the loans pie and requires special considerations. Banks need to lobby inside their own organisations to have the Libor teams push their own respective powers that are comparable to the Fed [Federal Reserve bank of New York] and the ARRC for USD. ECAs have to be recognised as a special case but because export finance is such a small part of the problem to be fixed, it is being pushed to the back of the queue. The ECA market needs is a term SOFR but this has been delayed. ECAs will have to become special cases ("use cases"), because SOFR in arrears with a five day look back does not work for the emerging markets." (Bank; Europe)

The 'five day lookback period' mentioned to in these quotes refers to the use of compounded in arrears RFRs with a five banking day lookback period in line with the SONIA loan market conventions. The lookback period is designed *'to allow for payment certainty for borrowers when using an 'in arrears rate''* (LMA, 2021).

However, for sovereigns and borrowers in developing markets (rapidly growing jurisdictions in export and project finance), the five day lookback period is deemed insufficient. For emerging markets export finance and pre-export finance transactions, these deals often require local budgetary, central bank and/or parliamentary approval (LMA, 2021); processes that often take a significant amount of time because of the tight currency regulations in place. Furthermore, borrowers in emerging markets will also likely have to undertake a foreign exchange transaction in order to hold the currency to pay the loan.

Consequently, the time-intensive administrative processes combined with a foreign exchange transaction led the LMA (2021) to conclude, *'a compounded in arrear RFR with a five banking day Lookback Period would not be workable [for emerging markets]'.*

Some have suggested that the export finance and project finance markets could access fixed rates as a solution, such as the Bank of England fixed rate or the commercial interest reference rate (CIRR) if ECA direct lending is tapped into, but this will not be applicable to many borrowers, particularly in emerging markets where ECAs are reticent to enter into (TXF Research, 2021).

The other potential alternative is a compounded in advance structure (essentially this is the same as the compounded in arrears structure but involves a lookback period of an entire interest period) but this has not found favour because it involves the use of more 'out of date' RFRs.

Concluding comments

The aim of this research was to explore the impending impact of the cessation of Libor on trade finance. Using a mixed methodology that combined 136 quantitative survey responses with detailed qualitative insights from 10 consenting individuals. This report concludes:

There is a long way to go for corporates to successfully transition all of their Libor-linked exposures to a suitable alternative RFR. Corporates surveyed in this research have reportedly made very little progress in transitioning their Libor-linked exposures to an alternative RFR. This is largely because of the lack of support they have received by the banks and that they perceive other priorities (such as the fallout of Covid-19 and Brexit) as more important than Libor. To compound matters, there was a reported lack of understanding of what Libor cessation means and how to go about successfully transitioning their Libor-linked exposures to a RFR.

A clear disparity between the perceived level of support provided by the banks and the support received by the corporates. This suggests a breakdown in communication between the banks and the clients, with the latter citing that more detailed guidance and literature is needed to better tackle the issue of Libor transition. However, as this report and much of the prevailing literature highlights, there continues to be a lack of clarity on which RFRs should be used, with delays in the development of a forward-looking SOFR one of the biggest hurdles. Perhaps of more concern is that 46% of the banks do not plan to offer an alternative RFR by the end of Q4 2021 (32%) or in 2022 (14%). With the deadline looming closer, these data suggests that the clients of these banks will most likely not meet the deadline.

A great deal more focus is needed on the bilateral and syndicated loans market. To date, significantly more progress has been made in the derivatives markets compared to the cash product and loans markets. For instance, ISDA has already produced supplementary fallback language for the derivatives space which has been widely accepted globally. The same cannot be said of the loans market. To compound matters, tough legacy contracts where fallback language is not included or not suitable means that inappropriate long-term fallbacks (such as individual lenders' cost of funds) may apply from the end of 2021, or the various Libor 'tough legacy' laws solutions may impose an alternative which may or may not be suitable. This is especially problematic for borrowers in developing markets where they may have problems with exchange controls.

The banks continue to struggle as the uncertainty and lack of clarity around SOFR continues to grow. Most of the banks reported to have a strong grasp if Libor-related issues with 94% stating that their banks had a working reference group dedicated to transitioning their Libor-linked loans to an alternative RFR. Banks reported that it is relatively straightforward to implement the advice and guidance of their working groups but that the biggest hurdle to better engaging their clients is a lack of clarity around a forward-looking SOFR. For export finance and project finance, this is particularly problematic as 88% of deals across 2020 were financed in US dollars. Without a recommended term SOFR, the banks reported that it makes client engagement and support more challenging. Credit sensitive alternatives to SOFR are gaining additional attention given the Term SOFR delay.

Trade finance is in a precarious position as it heads into the final six months before the deadline arrives. Most of the trade finance banks reported a great deal of difficulty in transitioning their Libor-linked exposures to an RFR which, this report found, is why very little progress has been made. The driving reasons behind these difficulties lie primarily in the uncertainty and lack of clarity that exists on which RFRs should be implemented. To compound matters, very little progress has been made on RFRs for other currencies and markets (for example, the Euro, JPY and for Islamic financing), another hurdle for an industry that deals in multiple global and local currencies.

Appendix

Appendix 1: Key differences between Libor and the RFRs

Differences	Libor	RFRs
TENOR	Seven maturities (overnight, 1 week, 1 month, 2 months, 3 months, 6 months, and 12 months.	Overnight only
METHODOLOGY OF CALCULATION	Waterfall methodology (volume weighted average).	Based on transactions in active markets.
DEFINITION	Wholesale unsecured funding.	Can be unsecured (SONIA and ESTER or secured (SOFR and CORRA).
TRANSACTION SIZE	Minimum of 10 million (foe each currency).	Customisation by currency. For example, SONIA lower limit is £25 million whereas ESTER is €1 million.
REFERENCE TIME	Borrowing cost estimated at 11am GMT every day.	Average over the day. For example, SONIA is based on transactions between midnight and 6am GMT. SARON updated every day 10 minutes finishing at 6pm CET.
TRIMMED AVERAGE/MEDIAN	Trimmed average where the bottom four and highest four submissions are removed. The average is then calculated form the remaining submissions.	Trimmed volume weighted median of executed transactions. Each RFR 'trims' in a different way based on the underlying markets.
DECIMAL POINTS	Published to five decimal places.	Varies depending on the RFR. ESTER is three decimal places whereas SONIA is four decimal places.
BORROWING COST SPECULATION	Rate provided in advance.	Rate provided in arrears.
TERM RATE	Rate provided in advance.	Compounded in arrears to calculate the forward term rate.

Appendix 2: RFRs to replace existing Libor currencies

Jurisdiction	Working Group	Alternative Ref Rate	Rate Name	Administrator	Collateralisation	Publication Date	Description
	Working Group on Sterling Risk-Free Reference Rates	SONIA	Sterling Overnight Index	Bank of England	Unsecured	Reformed 23/04/2018 Legacy 31/03/1997	Unsecured rate that covers overnight wholesale deposit transactions
	Alternative Reference Rates Committee	SOFR	Secured Overnight Financing Rate	Federal Reserve Bank of New York	Secured	02/04/2018	Secured rate that covers multiple overnight repo market segments
	The National Working Group on CHF Reference Rates	SARON	Swiss Average Rate Overnight	SIX exchange	Secured	22/09/2009	Secured rate that reflects paid on interbank overnight repo
	Study Group on Risk-Free Reference Rates	TONAR	Tokyo Overnight Average Rate	Bank of Japan	Unsecured	30/12/1992	Unsecured rate that captures overnight call rate market
	Working Group on Risk-Free Reference Rates for the Euro Area	ESTER	European Short Term Euro Rate	European Central Bank	Unsecured	October 2019	Unsecured rate that captures overnight wholesale deposit transactions

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