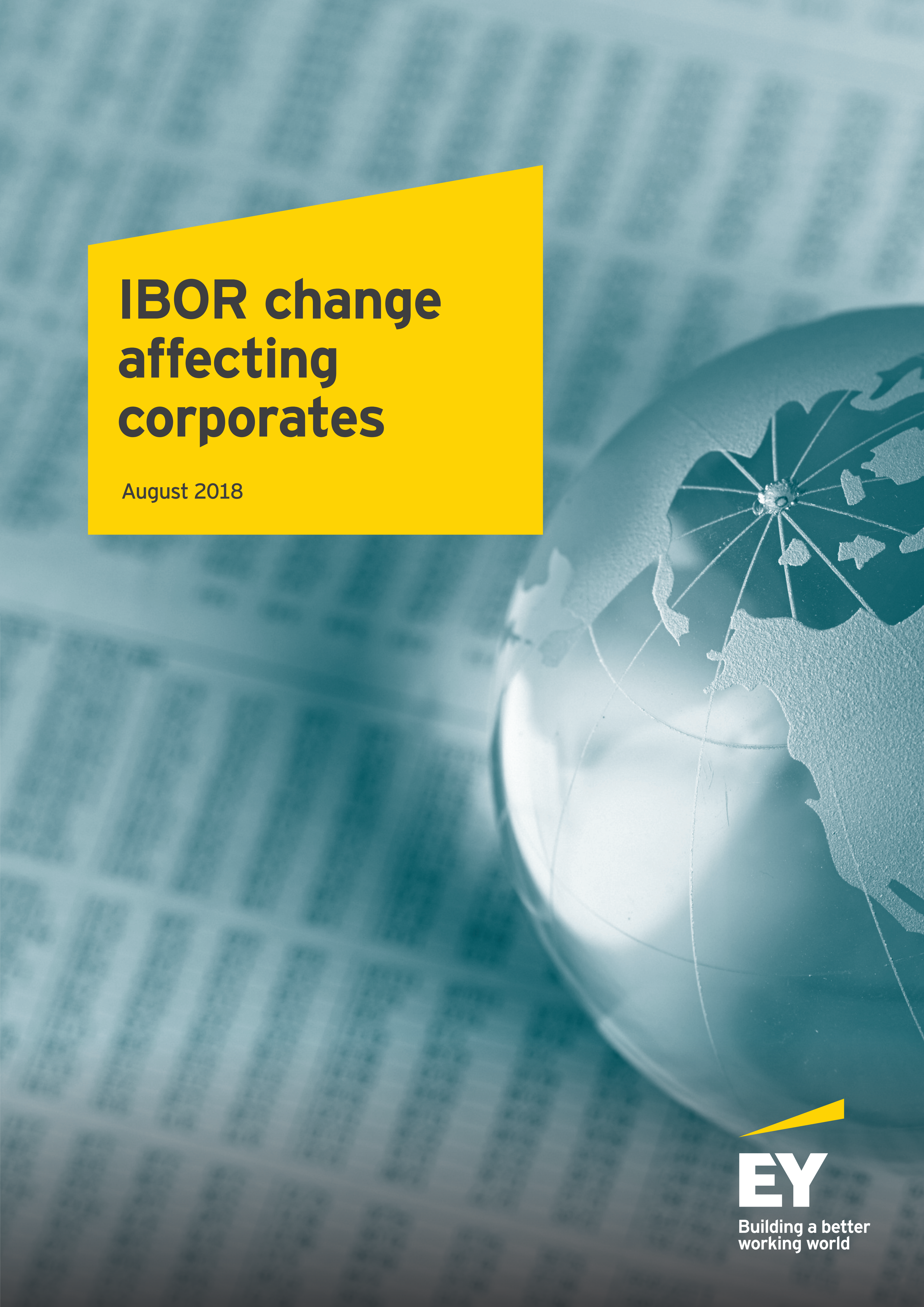

IBOR change affecting corporates

August 2018

Building a better
working world

Transition background

Interbank offered rates (IBORs) play an integral role in the global financial markets. In the aftermath of the financial crisis, their reliability and robustness were undermined by alleged manipulation and liquidity decline in the interbank unsecured funding markets.

Since 2009, the official sector and market participants have undertaken a series of initiatives to restore the governance and oversight of major interest rate benchmarks. Markets across the globe have taken steps to reform their existing rates in line with the Financial Stability Board (FSB) and the IOSCO Principles. Some jurisdictions have established RFR Working Groups (WGs) to conduct reviews and identify alternative RFRs[1]:

Jurisdiction	Current benchmark	Linked volume	Recommended alternative RFR
CH	CHF LIBOR TOIS	over US$6.5t	The National WG on CHF Reference Rates recommended the Swiss average rate overnight (SARON).
EU	EURO LIBOR, EURIBOR	over US$150t	Not yet selected. The ECB has launched a public consultation to gather feedback on three candidate euro risk-free rates: (i) The euro short-term rate (ESTER); (ii) GC Pooling Deferred; and (iii) RepoFunds Rate.
UK	GBP LIBOR	over US$30t	WG on Sterling RFR recommended the reformed Sterling overnight index average (SONIA).
US	USD LIBOR	over US$150t	Alternative Reference Rates Committee recommended the secured overnight financing rate (SOFR).
JP	JPY LIBOR, TIBOR	over US$30.0t	Study Group on Risk-Free Reference Rates recommended the Tokyo overnight average rate (TONA).

Defined milestones so far

2016 | **2017** | **2018** | **2021**

- **Dec '16** TONA selected
- **Apr '17** Reformed SONIA selected
- **Jun '17** SOFR selected
- **Sep '17** EU WG launched
- **Oct '17** SARON selected
- **Nov '17** Financial Conduct Authority (FCA) announced support to sustain LIBOR until 2021
- **Q2 '18** SOFR publication expected April 3, 2018
- **Apr '18** Reformed SONIA in effect
- **End 2021** FCA to stop sustaining LIBOR submissions[2]

Three potential transition challenges for corporates (non exhaustive)

Financing and hedging strategies

Change in reference and benchmark rates will require changes in the financing and hedging strategies. If not considered early enough increased costs and negative income effects due to ineffective hedge relations can arise.

(L)IBOR based contracts and contract clauses

The inventory of "(L)IBOR based" contracts and contracts with (L)IBOR clauses is vast and awareness thereof not necessarily given. Non timely adaption and conceptual rethinking is considered a high risk.

System readiness

If treasury and treasury related systems capturing market data and financial products will not be adapted in time, substantial manual workarounds will be required leading to increased risks of errors and lack of control.

1 The scope of the IBORs listed are those in which an RFR WG is currently operative or being established. Regulatory reform initiatives are underway in other jurisdictions. For further information, please consult with the relevant trade association representatives.
2 Source: Andrew Bailey's speech on The future of LIBOR, July 2017.

Main impact areas for corporates

Treasury	▸ Change in pricing methods for banking products (derivatives, cash pools, etc.) leading to substantial impacts on valuations, intercompany pricing, etc. ▸ Hedging strategies or hedge accounting approaches to be challenged and therefore impacts on legacy hedges are to be considered ▸ Funding strategies uncertain with regards to variable financing based on IBOR having impact on an organization's asset and liability management ▸ Supplier financing contracts and working capital programs to be re-negotiated and re-priced
Tax and Legal	▸ All contracts related to IBOR rates impacted and to be re-negotiated (e.g. ISDA, CSA, cash pooling contracts, early payment clauses in client contracts, etc.) ▸ Transfer Pricing documentation to be updated where a reference is made to IBOR rates ▸ Advance tax rulings addressing intra-group financing transactions to be amended ▸ Book value of debt instruments and certain other assets and liabilities may potentially change – impact on current and deferred taxes incl. correct distinction between P/L and Equity (OCI) impacts to be analyzed
Technology	▸ Incorporation of new and adjusted products into treasury and treasury related systems (TMS, trading platforms, confirmation matching tools, market data providers etc.) ▸ New interest rate (curves) required next to the "legacy" (L)IBOR curves impacting valuation models and interest calculations of financial instruments ▸ Technical "novation" of existing (L)IBOR based trades to be considered ▸ Adjustments on interfaces such as market data feed will be required

EY approach and service offering for corporates

Treasury
Tax and Legal
Technology

Assess

- Project mobilization and education
- Internal communication e.g., to Board of Directors
- Conduct impact assessment throughout the company to identify impacted areas, processes, contracts, systems and internal/ external stakeholders
- Develop inventory of impacts and define risks

Define

- Identify measures to take based on impact assessment through the dimensions Treasury, Tax and Legal and Technology
- Prioritize actions and align where required with internal and external stakeholders (e.g., banks, guarantors, tax authorities etc.)
- Develop roadmap for implementation

Implementation support

- Negotiation with external stakeholders regarding contract amendments
- Re-design hedging and financing strategies where required
- Adjust impacted systems and customize where needed
- Update and create documentations (e.g., policies, transfer pricing documents where applicable)

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