LIBOR Transition Frequently Asked Questions

Q1) What is LIBOR and how is it used?

LIBOR, or the London Interbank Offered Rate, is a benchmark rate at which banks estimate they can lend money to other banks on an unsecured basis. It is a daily benchmark interest rate taken from the average of the submission from a panel of banks and calculated across 5 currencies (USD, GBP, EUR, CHF, JPY) and 7 tenors (overnight, 1-week, 1-month, 2-month, 3-month, 6-month and 12-month). LIBOR is published and administered by the ICE Benchmark Administration every applicable London business day.

Apart from providing an indication of interbank lending, LIBOR is also widely used as a benchmark for various financial contracts including derivatives, bonds, loans and consumer lending products in calculating interest rates and valuations, and it is estimated to be referenced in over US$400 trillion of financial products.

Q2) Why and when is LIBOR going away?

Post the financial crisis in 2008, international regulators and panel banks began to question the long-term sustainability of the LIBOR framework due to the increasing reliance on expert judgement from the panel banks and insufficiency of transaction data.

The Financial Conduct Authority (FCA) has confirmed on 5 March 2021 the timeline for the cessation and non-representativeness of the 35 LIBOR benchmark settings currently published by the ICE Benchmark Administration (IBA). IBA will cease the publication of all GBP, EUR, CHF and JPY LIBOR settings, and the 1 Week and 2 Month USD LIBOR settings immediately following the LIBOR publication on December 31, 2021 and cease the Overnight and 1, 3, 6 and 12 Month USD LIBOR settings immediately following the LIBOR publication on June 30, 2023. In response to the decommissioning of LIBOR, global regulators have set up industry working groups to develop alternative reference rates (“ARRs”) to be used as the new financial benchmarks.

For all LIBOR currencies (USD, GBP, EUR, CHF and JPY), the respective ARRs have already been published.

For non-LIBOR currency jurisdictions, the transition timeline may vary across different jurisdictions. In Hong Kong, the HKMA expects banks to be in a position to offer products referencing new ARRs from 1 January 2021 and announced in March 2021 that banks should cease to issue new LIBOR-linked contracts **by the end of 2021**.

Q3) What are the key ARRs that have been identified?

The ARR for each of the 5 LIBOR currencies (USD, GBP, EUR, CHF and JPY) has already been published and endorsed by the corresponding regulators. Unlike LIBOR which has a forward-looking structure, these ARRs are overnight, nearly risk-free rates, and uses historical transactions as a basis for calculation, hence ARRs is a backward-looking rate.

LIBOR currency	Approved ARR	Regulator	Rate Type
USD	SOFR (Secured Overnight Financing Rate)	Federal Reserve Bank of New York	Secured
GBP	SONIA (Sterling Overnight Index Average)	Bank of England	Unsecured
EUR	€STR (Euro Short-Term Rate)	European Central Bank	Unsecured

CHF	SARON (Swiss Average Rate Overnight)	SIX Swiss Exchange	Secured
JPY	TONAR (Tokyo Overnight Average Rate)	Bank of Japan	Unsecured

Q4) Will the LIBOR transition affect any of my existing contracts with the Bank?

The LIBOR transition may impact one or more of your existing contracts with the Bank if they are referenced to LIBOR with a maturity **beyond the end of 2021**. If you currently have existing contracts that reference LIBOR with a maturity **before the end of 2021**, they may also be impacted upon the occurrence of a Non-representative Pre-cessation Event before the end of 2021. These contracts may need to be amended to include a new ARR in the fallback provisions.

Although most contracts currently include fallback provisions that cover situations when LIBOR becomes unavailable, these previous fallback provisions were only constructed to address a temporary disruption to LIBOR instead of a permanent LIBOR discontinuation. These previous fallback languages need be updated to address the ARR upon the cessation of LIBOR.

Q5) What happens to my existing derivatives referencing LIBOR?

If you currently have any existing derivative contracts (e.g. interest rate swap) referencing LIBOR with a term maturing beyond 2021 (or before the end of 2021 upon the occurrence of a Non-representative Pre-cessation Event), you are likely to be affected by the existing fallback provisions regarding the benchmark interest rate which is subject to changes. Echoing with Q5, typical derivative contracts include previous fallback provisions outlining the event in which LIBOR becomes temporarily disrupted. However, previous fallbacks do not include contractual provisions that contemplate a scenario of the permanent cessation of LIBOR.

For most of the over-the-counter (“OTC”) derivative contracts, the transactions are governed by the standard agreement of International Swaps and Derivatives Association (“ISDA”). ISDA has launched the IBOR Fallbacks Supplement (“the Supplement”) and IBOR Fallbacks Protocol (“the Protocol”) on 23 October 2020. The Supplement amends ISDA’s standard definitions for interest rate derivatives and includes a recommended fallback methodology in determining the appropriate replacement of the referenced LIBOR upon its discontinuation for derivative contracts. The Protocol and the Supplement will take effect on 25 January 2021. The Bank has been closely monitoring the latest updates from ISDA including industry movement and endeavors to adhere to the Protocol by incorporating the revisions into the existing LIBOR-linked derivatives contracts where applicable, and will discuss with you about the amendments shortly.

Q6) What happens to my existing cash products referencing LIBOR?

Similarly, if you currently have an existing contract for cash products (e.g. loan facility) referencing LIBOR with a term maturing beyond 2021 (or before the end of 2021 upon the occurrence of a Non-representative Pre-cessation Event), key considerations need to be placed on the existing fallback provisions. However, unlike derivative contracts, the contractual terms and documentation for cash products tend to be considerably varied, therefore there will not be a standard protocol mechanism centrally managed by an industry group (e.g. ISDA) for the contract amendments of existing cash product contracts.

In spite of this, industry bodies have been actively driving reform efforts in working towards the determination of the new fallback language for various cash products, the Alternative Reference Rates Committee ("ARRC"), Loans Market Association ("LMA"), the International Capital Markets Association ("ICMA") have proposed suggested fallback provisions for loans and bonds upon the discontinuation of LIBOR, and are continuing to explore further enhancements as well as feasibility along with other industry bodies. Depending on the industry updates, the Bank will let you know if the amendments are ready for discussions with you.

Q7) What about fixed rate products and LIBOR-referenced products but having a term *before* the end of 2021?

If your contracts have a fixed interest rate (e.g. term deposit), they will not be impacted as they are based on a fixed interest rate which is not tied to LIBOR.

However, for contracts referencing LIBOR with a term maturing ***before*** the end of 2021, there may still be potential impacts on existing fallback provisions regarding the benchmark interest rate upon the occurrence of a Non-representative Pre-cessation Event before the end of 2021. Please also refer to Q9 for an exceptional case for contracts maturing before the end of 2021.

Q8) How does the change affect my interest payments after switching to ARR?

The existing loan facility that references LIBOR may need to be replaced by an alternative reference rate, leading to a change in interest rate and amounts payable under the facility. For an existing **loan facility** referencing LIBOR with interest payable ***in advance***, the interest payment amount is predetermined at the start of the interest calculation period. However, in the light of the LIBOR reform, interest payable ***in arrears*** referencing the new ARR may be adopted where the interest payable will only be known towards the end of the interest period.

The Bank is currently assessing which product type will be affected by this change of interest calculation method. If your existing contract is impacted by LIBOR decommissioning, our Relationship Manager will be contacting you to discuss the potential changes on your existing contract for renegotiations to ensure your smooth adaption after switching to ARR.

Q9) How does the transition affect the pricing of my existing LIBOR-referenced contracts after switching to ARR?

The LIBOR transition will affect the pricing and interest payments of the existing LIBOR-referenced contracts due to the difference in interest rate structure between LIBOR and ARRs. Taking a LIBOR-referenced floating rate facility as an illustrative example, the rate is currently determined as the LIBOR rate (e.g., 1-month LIBOR) plus a pricing spread (e.g., 100bps). While switching to the new ARR rate for USD (i.e., SOFR), the 1-month LIBOR rate would be replaced by the SOFR rate which is typically lower than the LIBOR rate plus a credit spread adjustment. The credit spread adjustment would be determined based on the industry standards. The addition of the credit spread is intended to minimize the economic impacts of the existing contracts arisen from the transition from LIBOR to the new ARR rates.

ISDA confirmed the occurrence of the "Spread Adjustment Fixing Date" on 5 March 2021 for all LIBOR tenors across all LIBOR currencies which means that market participants could now use the fixed spread adjustments as a reference to confirm the pricing structure for actively transitioning facilities under the historical median approach. The Bank will closely track the development of spread adjustments for transitioning LIBOR-linked contracts and refine related ARR product pricing strategies accordingly.

Q10) What if my current contract is maturing *before* 2021, but it can / will be automatically renewed?

If your existing contract is referenced to LIBOR with a maturity *before* the end of 2021, but contains an “evergreen” clause which allows a term renewal beyond 2021 without renewing the contract, it will also need to be amended to include new fallback language contemplating the cessation of LIBOR beyond 2021. Otherwise, the contract may become invalid after the discontinuation of LIBOR in 2021 by continuing to refer to a non-representative rate.

Q11) I have a HKD facility referencing HIBOR as the interest rate benchmark, will this be impacted by the LIBOR transition?

If you currently have an existing contract referencing the Hong Kong Interbank Offered Rate (“HIBOR”) as the interest rate benchmark, the LIBOR transition does not have an impact on you at the moment. The HKMA currently have no plans to discontinue HIBOR. Whilst the Hong Kong Dollar Overnight Index Average (“HONIA”) has been selected as the alternative reference rate to HIBOR, HIBOR is expected to continue alongside HONIA for a period of time. The Bank is closely monitoring the latest market developments which may potentially impact your HKD facility contracts, and will let you know if there is any update.

Q12) What if I am planning to sign new contracts referencing LIBOR with the Bank?

In order to align with the overall transition timeline from LIBOR to ARR, we are working to amend the standard fallback provisions for new contracts referencing LIBOR and maturing after 2021. We are currently in the process of determining the appropriate amendment terms across different products that require conversion from LIBOR to respective ARR. If you will enter into any new contract with the Bank in the next few months, it is possible that the contract will have fallback provisions that may need to be amended later once the Bank finalized the contract amendment terms. Our Relationship Managers will discuss with you the details of such potential contract amendments at the time of signing the contract in the future.

Q13) What is the market doing to prepare for the large population of contracts that need to be amended?

There is a large number of existing contracts estimated to be impacted by the LIBOR transition, between now and the time LIBOR ceased to be published. There will be a large population of contracts that need to be amended and negotiated which requires a significant amount of effort and planning. In order to facilitate the large amount of contract amendments which may take place in the near future, there are a number of key market developments in progress which may support the contract amendment process including the recalibration and enhancement in operational systems, supporting software and applications, as well as the publication of ARR index and relevant market-approved credit spreads. The Bank will continue to adopt the optimal market approach and benchmarking against industry best practices to streamline the operational process.

Q14) What is the Bank doing to prepare for the transition?

Apart from actively monitoring the latest market developments and industry updates regarding LIBOR transition, the Bank is also consolidating relevant industry best practices and market approach in developing the appropriate fallback provision and alternative ARR regarding the potential contract amendments and remediation planning. We have also arranged multiple rounds of training programs for our Relationship Managers in relation to the transition and associated risks.

Q15) When should I expect to hear from the Bank regarding the contract amendments?

Given the different transition timeline and speed depending on different jurisdictions, we intend to take into account any potential development of ARR, relevant industry conventions and market practices before finalizing the preparation of new contract terms. Your dedicated Relationship Manager is expected to contact you regarding any existing contract(s) if they are impacted by the LIBOR transition shortly.

Q16) Who should I contact for more information?

You are encouraged to get in touch with your dedicated Relationship Manager if you have any questions regarding the potential impacts of the LIBOR transition. We also intend to provide more updates on this subject continuously to help you stay up to date on the latest market developments and the Bank's progress in the transition.

Q17) Where can I find more references on LIBOR and ARRs?

We have included some useful references from external industry bodies or related institutions on LIBOR transition and benchmark reform. You may refer to the references below for more market information and how this change may impact you or your business.

Regulatory Working Group	Reference
Working Group on Sterling Risk-Free Reference Rates (UK)	https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor
Working Group on Euro Risk-Free Rates (EU)	https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html
Alternative Reference Rates Committee (US)	https://www.newyorkfed.org/arrc
Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (Japan)	https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/
The National Working Group on CHF Reference Rates (Swiss)	https://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates

Industry Group	Reference
International Swaps and Derivatives Association (ISDA)	https://www.isda.org/ https://www.isda.org/category/legal/benchmarks/
International Capital Market Association (ICMA)	https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/benchmark-reform/
Loan Market Association (LMA)	https://www.lma.eu.com/libor
Loan Syndications and Trading Association (LSTA)	https://www.lsta.org/
Asia Pacific Loan Market Association (APLMA)	https://www.aplma.com/
Treasury Markets Association (TMA)	https://www.tma.org.hk/en_market_LIBOR.aspx
Asia Securities Industry and Financial Markets Association (ASIFMA)	https://www.asifma.org/ https://www.asifma.org/wp-content/uploads/2020/07/asifma-aplma-icma-isda-ibor-transition-guide-for-asia.pdf

Other Relevant Regulators / Institutions	Reference
International Organization of Securities Commissions (IOSCO)	https://www.iosco.org/
Financial Conduct Authority (FCA)	https://www.fca.org.uk/markets/libor
Financial Services and Markets Authority (FSMA)	https://www.fsma.be/en
European Securities and Markets Authority (ESMA)	https://www.esma.europa.eu/policy-rules/benchmarks
Financial Stability Board (FSB)	https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/financial-benchmarks/

Hong Kong Monetary Authority (HKMA)	https://www.hkma.gov.hk/eng/