The Future of LIBOR Frequently Asked Questions

The purpose of this document is to provide information to SMBC Group[1]'s customers and counterparties regarding the likely discontinuation of the London Interbank Offered Rate ("**LIBOR**") and to outline key aspects of this forthcoming change. The information provided on this website is provided for information only and it is not complete or exhaustive and does not constitute legal or regulatory advice. SMBC Group is not providing any advice or recommendation; if you wish to receive advice you should obtain your own independent professional advice on the potential impact of interest rate reform, including LIBOR discontinuation, on your business.

What is LIBOR?

The London Interbank Offered Rate or "LIBOR" is an interest rate benchmark administered by ICE Benchmark Administration Limited.

LIBOR is a widely used benchmark for short-term interest rates, providing an indication of the average rates at which certain banks (referred to as LIBOR "panel banks") could borrow from other banks on an unsecured basis for set periods of time and in particular currencies.

LIBOR is often referenced in loan, derivative and bond documentation, as well as in other types of documentation, to calculate interest payments under those products. It is also used for other purposes in the market such as, for instance, as a performance target or benchmark for funds, to value certain products, to calculate discount rates or performance ratios, to assess market expectation regarding central bank interest rates and liquidity in the interbank lending market and, during periods of stress, as an indicator of the health of the banking system.

LIBOR is currently produced for five currencies (CHF, EUR, GBP, JPY and USD) and seven tenors or time periods (Overnight / Spot Next, 1 Week, 1 Month, 2 Months, 3 Months, 6 Months and 12 Months). It is based on submissions from panel banks, which indicate the rate at which they could borrow from other banks, resulting in the publication of 35 rates across tenors and currencies every applicable London business day.

Sumitomo Mitsui Banking Corporation Europe Limited is a LIBOR panel bank for USD and JPY.

Further information about LIBOR is available at: **https://www.theice.com/iba/libor**.

Why is it changing?

The integrity of LIBOR was called into question during the height of the financial crisis when several banks contributing to its calculation were accused of manipulation of the rate. There followed a contraction in the unsecured interbank lending market and the future of LIBOR was placed in doubt.

In 2014, the Financial Stability Board published a report[2] explaining that benchmarks, such as LIBOR, should be based on actual transactions to the greatest extent possible. Certain changes were therefore made to the way in which LIBOR is calculated to try and base it on transactions to a greater extent but, because there are now fewer banks lending to each other on an unsecured basis, LIBOR is often calculated by reference to "expert judgement" by panel banks (i.e. estimates regarding how much they think it would cost them to borrow from other banks).

In July 2017, Andrew Bailey (the Chief Executive of the UK Financial Conduct Authority) made a speech[3] in which he explained that, despite efforts to base LIBOR more firmly in transactions, the underlying market which LIBOR seeks to measure (i.e. unsecured interbank lending) is no longer sufficiently active. He announced that, whilst LIBOR panel banks had agreed to continue submitting to LIBOR until the end of 2021, after this date the FCA does not intend to compel banks to submit to LIBOR.

This means that LIBOR is widely anticipated to be discontinued. As a result, the FCA and other regulators are requiring banks to plan for the cessation of LIBOR by the end of 2021 and are encouraging market participants to instead transition to using alternative "risk-free" rates ("**RFRs**") instead of LIBOR.

Do the changes only affect LIBOR?

No. Other interbank offered rates ("**IBORs**") are also being reformed so that they are calculated wherever possible by reference to actual transactions (e.g. the Euro Interbank Offered Rate or "**EURIBOR**"). It is possible that other IBORs may also be discontinued, such as the Euroyen Tokyo Interbank Offered Rate ("**Euroyen TIBOR**") which experienced similar issues to LIBOR. The Euro Overnight Index Average ("**EONIA**") is also undergoing reform due to a lack of underlying transactions and will be discontinued on 3 January 2022.

When will LIBOR be phased out?

After the end of 2021, the FCA has indicated that it does not intend to persuade or compel panel banks to submit the rates required to calculate LIBOR. This means that LIBOR may be discontinued after the end of 2021 although precise timing is not yet known.

The UK FCA has indicated that firms should treat the discontinuation of LIBOR as "something that will happen" [4] and Chairman J. Christopher Giancarlo of the US Commodity Futures Trading Commission said "the discontinuation of LIBOR is not a possibility. It is a certainty."[5]

Regulators are encouraging firms and clients to transition away from the use of LIBOR to new rates as soon as they are able to and the FCA and the Prudential Regulation Authority (PRA) in the UK sent so-called "Dear CEO" letters to CEOs of major banks and insurers supervised in the UK asking for details of the preparations and actions they are taking to manage transition from LIBOR to alternative interest rate benchmarks. Other regulators have since sent similar letters to certain regulated entities.

Which rates are likely to replace LIBOR?

Risk-free rates or "RFRs" are likely to replace LIBOR. RFRs are overnight interest rate benchmarks which are perceived by the FCA and other regulators to be more representative and reliable than LIBOR. This is because these benchmarks are intended to be based on liquid markets and so they can be calculated by reference to actual transactions.

A number of RFR working groups were set-up across a range of countries to identify alternative RFRs for the relevant currency. The RFR which has been chosen by those working groups for each currency is shown below.

Libor currencies		Proposed replacement		Based on transactions which are
GBP	British pound sterling	Sterling overnight index average	**SONIA**	unsecured
EUR	Euro	Euro short-term rate	**€STR**	unsecured
USD	United States dollar	Secured overnight funding rate	**SOFR**	secured
CHF	Swiss franc	Swiss average rate overnight	**SARON**	secured
JPY	Japanese yen	Tokyo overnight average rate	**TONAR**	unsecured

In addition to the RFRs mentioned above, some currencies have other IBORs, such as EURIBOR in the eurozone and TIBOR in Japan. It is possible that, in some cases, market participants may choose to use these rates alongside the relevant RFR and in place of Euro LIBOR or Japanese Yen LIBOR respectively. However, as mentioned above, some of these IBORs are subject to reform because they suffer from similar issues to LIBOR and so market participants may prefer to use RFRs instead.

SMBC

Will the proposed alternative RFR differ materially from LIBOR?

The alternative RFRs differ from LIBOR in three main ways:

1. Alternative RFRs are overnight rates which are published at the end of the overnight borrowing period. This means they are "backward-looking". In contrast, LIBOR is a term rate (i.e. it is a rate to borrow for a period of time such as 3 months or 6 months) and it is published at the beginning of the borrowing period. This means LIBOR is "forward-looking".
2. LIBOR also includes a premium for interbank credit risk (i.e. an additional amount to account for the risk that the borrowing bank may not be able to repay the interbank borrowing). RFRs, which are overnight rates and, in some cases, secured do not include this premium or include a reduced premium.
3. LIBOR also measures the same market in all currencies (i.e. the unsecured interbank lending market). The RFRs measure different markets. For example, the RFRs for Sterling, Japanese Yen and Euro are based on unsecured markets whereas the RFRs for US Dollar and Swiss Franc are based on secured markets. This means that different RFRs are likely to behave slightly differently.

Some market participants have indicated that, for their interest rate products, they need to know the rate of interest at the start of the borrowing period. As a result, some public/private sector RFR working groups (which were responsible for choosing the RFRs) are now considering whether forward-looking term versions of the RFRs can be developed.

The Working Group on Sterling Risk-Free Reference Rates anticipates that a term SONIA reference rate could be available in Q1 2020[6]. The US Alternative Reference Rates Committee (ARRC) is attempting to develop term SOFR by the end of 2021[7]. The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks[8] and the Working Group on Euro Risk-Free Rates[9] are considering the development of forward-looking term RFRs. The National Working Group in Switzerland has indicated that a robust forward-looking term version of SARON is not currently feasible but that, if the situation changes, this may be reassessed.[10]

What impact will this change have?

Given that LIBOR is widely used, including in some of SMBC Group's products, this change may impact (amongst other things) products you currently have or obtain in the future, your systems and processes and tax and accounting treatment. Some of the impacts of LIBOR discontinuation are considered below. This is provided for information only and is not complete or exhaustive. If you wish to receive advice on any aspect of LIBOR and/or IBORs and/or RFRs as may affect your products with SMBC or otherwise, you should seek independent professional advice on that. SMBC is not providing any advice or recommendation to you nor is it assuming any responsibility to provide advice.

1. **Payments under a product may be affected**
   If payments under a product such as a loan, deposit, bond or a derivative are calculated by reference to LIBOR, the consequences of LIBOR discontinuation will depend on the terms of the contract. The contract may not specify what should happen if LIBOR is discontinued or, if it does, the so-called "fallbacks" or consequences may not be suitable. Alternatively, fallbacks may apply which result in the application of a new benchmark in place of LIBOR or the parties may agree to apply a new benchmark. Depending on how that new benchmark compares to LIBOR, this may mean that payments under that product may be more or may be less than they would otherwise have been.
2. **The value of the product may change**
   A change in benchmark may also affect the value of the product (i.e. the mark-to-market value of a derivative or the secondary market value of a certificated deposit, loan or bond) so that it is worth more than or less than it would otherwise have been. If the value of a product changes, this could also have other implications for you, by way of example only, in relation to tax. You should obtain your own independent professional advice as to any potential change in value of a product you hold as a result of a change in the benchmark for such product from a LIBOR to a RFR or an alternative benchmark.
3. **Operations and systems may be impacted**
   If a backward-looking overnight rate is used in place of LIBOR, interest will be calculated at the end of the interest period. Operations and systems which currently rely on the interest rate being known at the start of the period may therefore need to be updated to deal with this change. LIBOR may also be embedded within systems and infrastructure more generally and so if LIBOR is discontinued, those systems and infrastructure may need to change.

4. **Impact on hedging arrangements**
   If, for example, you have a loan with an interest payment obligation which is hedged by a derivative it may be that you are currently relying on hedge accounting rules in your financial arrangements. Mismatches between the way in which the loan and the derivative operate upon LIBOR being discontinued may impact the application of the hedge accounting rules to your financial arrangements.

In relation to all of the above, and any other impacts, you should therefore seek professional advice from appropriately qualified professionals.

What might be the impact on derivatives and what is happening to derivative documentation?

Standard wording for derivatives which use LIBOR to calculate floating rate payments in interest rate swaps currently includes certain "fallbacks" but these are not expected to operate effectively if LIBOR is permanently discontinued. It may therefore be unclear what rate should be used if those provisions are not updated.

The International Swaps and Derivatives Association, Inc. ("**ISDA**"), which is an industry body that focusses on derivatives, is planning to update this standard wording to include new "fallback" provisions which will apply if LIBOR is permanently discontinued.

The updated "fallbacks" on which ISDA is working are intended to provide that, upon the occurrence of the relevant event (e.g. permanent discontinuation of LIBOR), references to LIBOR will be replaced with references to a rate based on the RFR in the same currency. The fallbacks are still in consultation and drafting phase and are only intended to apply to new derivatives that use this standard wording. Therefore, ISDA will also produce a "protocol", which is a mechanism that parties can use to amend existing derivatives with multiple counterparties by adhering on the ISDA website, to allow parties to include the same fallbacks in existing derivatives.

SMBC will continue to monitor ISDA published fallbacks and protocol developments to assess whether these are appropriate for the derivatives products that SMBC may trade with you.[11]

The value of derivatives may be affected by these changes. Additionally, mismatches may arise if a derivative is used to hedge a loan which does not deal with LIBOR discontinuation in the same way as the derivative.

To the extent that derivatives are documented under non-ISDA documentation, SMBC will explore possible approaches under that documentation as market standards develop.

SMBC will continue to communicate with its customers and counterparties with a view to facilitating a smooth transition away from LIBOR for all product categories, including hedging instruments.

What might be the impact on loans and what is happening to loan documentation?

Loan documentation generally also includes some fallbacks which apply if LIBOR is discontinued but, as with derivatives, these fallbacks have in the past generally not been intended to deal with a permanent discontinuation of LIBOR.

The Loan Market Association ("**LMA**"), which is an industry body that focusses on loans, has therefore published certain standard "replacement of screen rate wording" which is intended to facilitate amendments to be made upon the occurrence of certain events (including permanent discontinuation of LIBOR, the designation of a replacement rate and/or a determination that a successor rate has generally been accepted in the international or any relevant domestic market) with a lower consent threshold than may otherwise be required in a wider range of circumstances.

It is possible that the LMA will develop additional standard wording to transition to an alternative prescribed benchmark, either being a forward-looking term version of the RFR when and if such a rate becomes available and/or a backward-looking compounded overnight rate.

The secondary market value of loans may also be affected by these changes. Additionally, mismatches may arise if a derivative is used to hedge a loan which does not deal with LIBOR discontinuation in the same way as the derivative.

SMBC will communicate with its customers and counterparties with a view to facilitating a smooth transition away from LIBOR for all product categories, including hedging instruments.

What might be the impact on bonds / notes / commercial paper / certificates of deposit and what is happening to bond / note / commercial paper / certificate of deposit documentation?

The documentation for bonds, notes, commercial paper and certificates of deposit referencing LIBOR generally (though not always) also includes fallbacks which apply if LIBOR is unavailable but, as with loans and derivatives, such fallback provisions were historically drafted in the context of a temporary disruption and not as a solution to a permanent discontinuation of LIBOR.

There is typically no mechanism in bond / note / commercial paper / certificate of deposit documentation to specify, after the issue date, an alternative interest rate and the terms of each such bond / note / commercial paper / certificate of deposit would require amendment, usually by bondholder / noteholder / commercial paper holder / certificate holder consent.

This area is constantly developing and language may therefore vary between products, different issuers and different markets. There may even be instances where issuances under the same programme (but with a different issue date) contain different provisions in respect of LIBOR discontinuation as the market approach to this issue evolves.

The secondary market value of bonds / notes / commercial paper / certificates of deposit referencing LIBOR may therefore be affected. Additionally, mismatches may arise if a derivative is used to hedge a bond / note / commercial paper / certificate of deposit which does not address LIBOR discontinuation in the same way as the derivative.

Where SMBC is not the issuer of the bond / note / commercial paper / certificate of deposit but is offering a secondary market product, SMBC does not set the terms of those products and you should be aware that such products may (i) not include any fallbacks, (ii) include fallbacks that differ from those included in a product issued by SMBC and / or (iii) be subject to a change of the benchmark and / or repricing as a result of the discontinuation of LIBOR.

How is SMBC preparing for the transition away from LIBOR?

SMBC is preparing for the discontinuation of LIBOR and the transition to alternative RFRs in a number of ways.

SMBC is participating in industry working groups that are considering the discontinuation of LIBOR and issues relating to interest rate reform in Japan.

SMBC is also engaging with its customers and counterparties to raise awareness on the consequences of a potential discontinuation of LIBOR.

SMBC is assessing how and where LIBOR is used in its products. Given that the precise replacement rates and the adjustments which need to be made to RFRs to make them suitable replacements for LIBOR have not yet been agreed at industry level, the impact on existing contracts is not yet known. SMBC will endeavour to contact, for information purposes only, those clients and counterparties in relation to affected products.

Where SMBC considers it to be appropriate in light of industry developments, SMBC is including more robust fallbacks in new contracts that reference a LIBOR, addressing the consequences of the discontinuance of LIBOR and providing for amendments to be made and / or for a replacement rate to be designated upon the occurrence of certain events in respect of the relevant LIBOR rate.

SMBC is developing products that reference RFRs with a view to being able to offer a broader range of RFR products prior to the discontinuation of LIBOR.[12]

What should you do now?

You should consider the impact of LIBOR discontinuation on your business, engage with industry working groups considering the issues wherever possible (for example, by responding to public consultations on the proposed solutions), raise awareness of the issues internally and review your existing products to understand where LIBOR is used. You should also consider obtaining independent professional advice on the potential impact of interest rate reform, including LIBOR discontinuation, on your business.

Where can I find more information?

If you would like to review further background information, the following websites contain useful information:

FCA
https://www.fca.org.uk/

Bank of England
https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor

Federal Reserve Bank of New York
https://www.newyorkfed.org/ and https://www.newyorkfed.org/arrc

US Commodity Futures and Trading Commission
https://www.cftc.gov/

European Central Bank
https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html

Bank of Japan
https://www.boj.or.jp/en/paym/market/sg/index.htm/ and
https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/

Financial Stability Board
https://www.fsb.org/

ISDA
https://www.isda.org/category/legal/benchmarks/

LMA
https://www.lma.eu.com/libor

In addition, the Association of Corporate Treasurers provides useful information from a corporate perspective
https://www.treasurers.org/liborreform

If I have any further questions relating to the discontinuation of LIBOR who can I contact?

For any queries relating to the discontinuation of LIBOR, please direct them to your Relationship Manager or contact GBLOLIBOR-Transition@gb.smbcgroup.com

---

1. SMBC Group (also referred to in this document as "**SMBC**") means Sumitomo Mitsui Banking Corporation Europe Limited and its branches, Sumitomo Mitsui Banking Corporation's branches in EMEA, SMBC Nikko Capital Markets Limited, SMBC Nikko Capital Markets Europe GmbH, SMBC Bank EU AG and its branches, Sumitomo Mitsui Finance & Leasing Co Ltd, SMBC Leasing (UK) Ltd and Sumitomo Mitsui Finance Dublin Ltd.
2. https://www.fsb.org/wp-content/uploads/r_140722.pdf
3. https://www.fca.org.uk/news/speeches/the-future-of-libor
4. https://www.fca.org.uk/news/speeches/interest-rate-benchmark-reform-transition-world-without-libor
5. https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement071218
6. https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/roadmap.pdf?la=en&hash=71F1BCB1B2D3BC158429CBD11FF7DC8A441A96DB
7. https://www.newyorkfed.org/arrc/sofr-transition#progress
8. https://www.boj.or.jp/en/paym/market/jpy_cmte/index.htm/
9. https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/

shared/pdf/20180913/Item_3_High_level_implementation_plan.pdf

10. https://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_NWG_milestones

11. For completeness we would like to draw to your attention that ISDA published the ISDA 2018 Benchmarks Supplement Protocol (the "**Protocol**"). This is separate to the work ISDA is doing on fallbacks for the IBORs (described above) and the Protocol is intended to help market participants to incorporate the previously published ISDA Benchmarks Supplement (the "**Supplement**") into certain derivative transactions. The Supplement was developed primarily to facilitate compliance by market participants with the EU Benchmarks Regulation but can also be used by market participants in connection with their transition away from inter-bank offered rates (such as LIBOR) to risk-free rates. More information can be found on the Protocol and Supplement respectively at the following ISDA website links: https://www.isda.org/protocol/isda-2018-benchmarks-supplement-protocol/ and https://www.isda.org/book/isda-benchmarks-supplement/.

12. SMBC Nikko Capital Markets Limited is currently able to offer SONIA based swaps. The development and availability of other products using alternative RFRs by the time of LIBOR discontinuation will be dependent on market developments.