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Transition from LIBOR and Alternative Reference Rates After the End of 2021

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Initial Situation

- The **London Interbank Offered Rate** (LIBOR) is one of the most important reference rates and plays a central role in the financial markets.
- The **decline of liquidity** on unsecured interbank lending markets after the financial crisis has **undermined confidence in the reliability of LIBOR.**
- The UK Financial Conduct Authority (FCA), which is responsible for monitoring the LIBOR reference rate, will **no longer support LIBOR as the global reference rate after the end of 2021**.
- **Alternative reference rates** have been identified in the different currency areas that will replace LIBOR after the end of 2021.
- In **Switzerland**, **SARON will replace LIBOR** at the end of 2021.
- This presentation highlights the **most important aspects of the transition from LIBOR**, the **alternative reference rates** and possible **implications for institutional investors**.

Reference Rates

Reference rates play an important role for financial markets:

- Reference rates serve as **benchmarks for contracts** that are linked to floating rates. Reference rates facilitate the pricing of financial contracts, reduce their complexity and facilitate standardisation.
- Reference rates are used for the **valuation of balance sheet items**, for example as the discount rate for certain financial instruments.
- **Derivatives markets** often use reference rates for instruments such as swaps, options and forward contracts (e.g. interest rate swaps use reference rates as floating rates).

▶ **The reference rate is important, especially as a benchmark for institutional investors.**

Transition from LIBOR

- **LIBOR** represents the **interest rate conditions** reported by leading banks for ***unsecured credits*** between banks in London.
- On 27 July 2017, the UK Financial Conduct Authority (FCA) announced that it will **no longer support LIBOR after the end of 2021**. This caused **insecurities regarding the future of LIBOR**.
- The reason for the transition is that the **market for unsecured credits is no longer active enough to guarantee that LIBOR is representative of the lending conditions of banks in the unsecured credit market**. Currently, LIBOR reports are mostly based on **expert judgement**, depending on the currency.

▸ **The transition from LIBOR by FCA presents a challenge to financial markets and highlights the need for the development of alternative reference rates.**

Alternative Reference Rates

- Working groups in the respective currency areas have recommended the following **alternative reference rates** to **LIBOR**:

Currency	Recommended alternative reference rate	Credit security	Maturity	Launch	Administrator
CHF	Swiss Average Rate Overnight ("**SARON**")	Secured	Overnight interest rate	August 2009	SIX Swiss Exchange
USD	Secured Overnight Financing Rate ("**SOFR**")	Secured	Overnight interest rate	April 2018	Federal Reserve Bank of New York
EUR	Euro-Short Term Rate ("**€STR**")	Unsecured	Overnight interest rate	October 2019	European Central Bank
GBP	Sterling Overnight Index Average ("**SONIA**")	Unsecured	Overnight interest rate	March 1997, reformed in April 2018	Bank of England
YEN	Unsecured Tokyo Overnight Average Rate ("**TONAR**")	Unsecured	Overnight interest rate	November 1995	Bank of Japan

Sources: SNB; FED, ECB, BoE, BoJ

Alternative CHF Reference Rate: SARON

- In Switzerland, the **National Working Group on Swiss Franc Reference Rates** (NWG) under the lead of the Swiss National Bank (SNB) is responsible for reforming reference rates in Switzerland. Participants from both the **private sector** and **SNB** are **part of NWG**.
- NWG recommends **SARON (Swiss Average Rate Overnight)** as the **alternative to CHF LIBOR**.
- SARON is the **secured CHF (repo) overnight interest rate**, i.e. the rate at which more than 150 banks and insurances lend money to each other.
- SARON covers the **most liquid** segment of the CHF money market. The rate is based on **completed transactions as well as binding pricing**.
- SARON is published as an **annualised rate**.

Forward Reference Rate

- One of the **challenges** in selecting alternative reference rates is the calculation of **forward reference rates** (e.g. as a replacement of the 3 month LIBOR) based on overnight interest rates.
- While, for example, the 3 month LIBOR as a forward reference rate refers to the future (the interest rate in the future is known today), **the 3 month SARON can only be determined retrospectively on the basis of realised overnight interest rates** (the interest rate in the future is not known today).
- Therefore, the **SARON reference rate** is not yet known at the time of **conclusion** and can only be definitely determined after expiry of the forward contract (e.g. after three months).
- Unlike LIBOR, **SARON** thus represents a **realised money market yield**. SARON can be understood as a total return index and is closer to an ex-post performance view.

Need for Action for Institutional Investors

- **Institutional investors** can be **affected** as follows:
  - **Asset management contracts** (especially benchmarks and performance fees)
  - Direct investments in **real estate** and **mortgages**
  - Direct **derivative overlays** with contracts over 2021

- It is recommended that, if possible, **new transactions** are already based **on the new alternative reference rates**.
- **Investment regulations**: It is advisable to review the investment regulations and adjust them to the new reference rates if necessary.

Conclusion

- The **future of LIBOR after the end of 2021** became much **more uncertain** following the announcement by the UK Financial Conduct Authority (FCA)**.** It is to be expected that LIBOR will **no longer exist** after the end of 2021.
- The National Working Group on Swiss Franc Reference Rates (NWG) has identified **SARON** (secured overnight interest rate) as the **alternative** for **CHF LIBOR**. SARON is also the basis for forward reference rates.

- **Institutional investors can be affected as follows:**
  - **Investment regulations (especially benchmarks and performance fees)**
  - **Direct investments in real estate and mortgages**
  - **Direct derivative overlays with contracts over 2021**
- **It is advisable to follow the reform, identify any need for action and, in particular, to review the investment regulations.**

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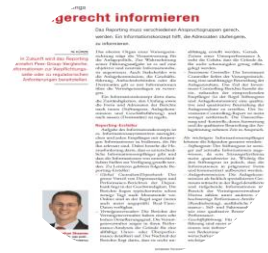

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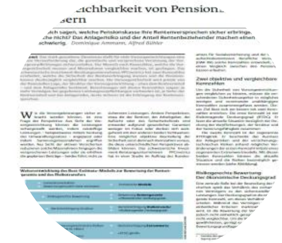

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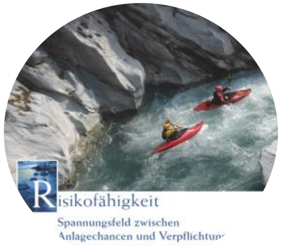

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