LIBOR, LEI AND CROSS-BORDER PAYMENTS

The traditional summer slowdown for the financial markets seems to be a thing of the past, but we hope you got a break, because this is going to be a busy run-up to the end of the year.

On top of all those one-off projects on your list, such as Brexit, bank ring-fencing and lease accounting, those with cash sitting in European money market funds will need to consider the potential impact of new regulation on your investment policies and accounting treatment. And everyone will need to add the potential demise of Libor as a topic to keep a close eye on – see the In depth article below.

Michelle Price (left) and Sarah Boyce (right) are the ACT's associate policy and technical directors, and are always pleased to hear from you, whether with questions or with comments on areas of particular concern or interest to you. You can reach them at technical@treasurers.org

{ IN DEPTH }

The end of Libor...?

You have no doubt heard by now about the potential demise of Libor. In late July, the UK's Financial Conduct Authority (FCA) announced that, from 2021, it will no longer put pressure on panel banks to contribute daily rates to the Libor administrator. This arguably removes all incentives for banks to contribute to such benchmarks.

Why has this decision been taken?

In 2013, the G20 commissioned the Financial Stability Board (FSB) to review systematically important interest rate benchmarks in response to a number of scandals and a decline in market liquidity. Put simply, the underlying market that Libor seeks to reflect (the unsecured interbank funding market) is no longer sufficiently liquid and so Libor is increasingly frequently an estimated rate rather than one based on actual transactions – and therefore more vulnerable to miscalculation.

The FSB recommended that a nearly risk-free reference rate was, in many cases, more suitable than a reference rate that included a bank credit risk component (such as Libor), and various central banks established working groups to implement this recommendation.

So, what are the possible alternatives?

Well, this rather depends on which currency you are using, as different markets have taken different approaches.

Some countries have decided that using a secured rate is appropriate. For example, Switzerland has selected the Swiss Average Rate Overnight (SARON), a collateralised rate based on the Swiss repo market. In the US, the Alternative Reference Rates Committee has chosen a new treasuries repo rate linked to the cost of borrowing secured against US government debt. This benchmark doesn't actually exist yet – so doesn't have a name.

Others have chosen to adopt an unsecured rate.

In the UK, the Risk-Free Rate Working Group recommended the use of the sterling overnight index average (SONIA) as the preferred near-risk-free rate. SONIA reflects bank and building societies' overnight funding rate in the sterling unsecured market and is currently going through a reform process to improve its robustness. Japan has selected the Tokyo Overnight Average Rate (TONAR) as the alternative to yen Libor. Similar to SONIA, this is an unsecured rate.

Further, we understand that the European Central Bank has begun working on its own index of bank-to-bank lending – one to watch.

Will Libor really die?

It's hard to tell at this stage, but treasurers need to be prepared that it may disappear. ICE Benchmark Administration could continue to produce Libor post-2021 if it chooses to do so, and its press release following the FCA's announcement stated that Libor has a "long-term sustainable future" – but it will need to figure out how to maintain integrity in the panels when the FCA 'compulsion' disappears.

What does this mean for corporates?

This will be an evolving topic and the ACT is already engaged with regulators and various trade associations to ensure that the corporate voice is not overlooked.

As a start, the following challenges will need to be resolved:

- **Liquidity risk:** tenors need to be 'forward-looking', for example, the six-month rate known in advance, in order for corporates to manage their cash flow and liquidity risk. Importantly, following the planned reform, SONIA will be published in the morning of the following day.
- **A benchmark curve:** SONIA is an overnight rate and doesn't currently have the set tenors, such as three-month and six-month rates, that Libor has.
- **Legacy contracts:** if Libor no longer existed or was fundamentally different to the benchmark it is today, there is the issue of legacy contracts that reference Libor, some extending out to 30-plus years.
- **Comparability of benchmark rates:** multinationals typically borrow in local currency, so will need to consider how to compare between different benchmarks (potentially one based on unsecured and another based on collateralised transactions) when deciding which currency to raise and/or swap their funding into.
- **Rules, rules, rules:** there will be accounting, regulatory and economic implications of switching benchmarks – just consider hedge accounting implications if existing contracts have to be 're-papered', for a start.

There will also be cost implications of transferring from one benchmark to another.

There are no easy answers and discussions have just begun. The ACT would welcome input from corporate treasurers to identify key issues and work with regulators in ensuring any replacement for Libor is fit for purpose for the real economy.

If you'd like to get involved, please drop us a line at technical@treasurers.org

ACT resources

View briefing notes, technical updates and policy submissions at www.treasurers.org/technical. In addition, there are web pages dedicated to Brexit, Best Practice (Codes of Conduct) and Libor reform, which can be accessed from the 'Technical Guidance and Comment' tab on the ACT's home page.

For more immediate responses to events as they occur, the policy and technical team continues to write various blogs at https://blogs.treasurers.org and we welcome guest bloggers.

If you have a topic that's keeping you up at night and would like to be a guest contributor, please get in touch at technical@treasurers.org

Implementing the Codes: The ACT has drafted a briefing note for each of the FX Global and UK Money Markets Codes to assist corporates in their implementation. These include a useful next steps list for those not really sure where to start! www.treasurers.org/codes

Correspondent banking: The FSB continues to monitor the decline in correspondent banking – relevant to everyone who moves money cross border. https://tinyurl.com/y7ukrpu4

Merger of financial trade bodies: UK Finance is the new body resulting from the merger of six existing organisations: the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and The UK Cards Association. www.ukfinance.org.uk/uk-finance-launches

Investments in equity instruments: The European Commission is trying to understand whether new accounting requirements under IFRS 9 will affect long-term investments in equity and so the European Financial Reporting Advisory Group (EFRAG) has published a questionnaire targeted at firms that invest in equity instruments and prepare their financial statements under IFRS. Further details are at https://tinyurl.com/y764muse. The deadline for responses is 30 September 2017.

{ REPORTING AND COMPLIANCE }

HAVE YOU GOT YOUR LEI?

Endorsed by the G20, the Legal Entity Identifier (LEI) initiative is designed to create a global reference data system that uniquely identifies every legal entity or structure, in any jurisdiction, that is party to a financial transaction to improve transparency and monitoring of risk.

Just a reminder that, in addition to the use of the LEI for derivatives reporting, depending on your jurisdiction (not just of domicile, but also the market in which you are operating), an LEI may also be required for bond issues, and investments by insurers and funds.

Regulations caught include European Market Infrastructure Regulation, Markets in Financial Instruments Regulation and Dodd-Frank.

More details about when an LEI is required can be found at www.leiroc.org/lei/uses.htm

{ INTERNATIONAL }

Europe – MMF changes

The EU's reformed money market fund (MMF) rules took effect in July and will become effective for existing European MMFs on 21 January 2019.

The biggest change is a new product category, the low-volatility net asset value (LVNAV) fund. In essence, LVNAV funds should maintain a constant NAV (CNAV) on most days; however, in a liquidity crisis, gates and/or fees can be applied and/or the fund moved to full mark-to-market pricing.

Prime CNAV funds will be phased out by January 2019 and MMF providers are expecting that a high percentage of assets currently held in CNAV will move to LVNAV funds, rather than switch to VNAV funds.

Corporate treasurers will need to assess whether their investment policy allows investment in funds other than CNAV and also reconsider the classification of investments in MMFs as Cash and Cash Equivalents under IAS 7 (IFRS), FRS 102 (UK GAAP) or FASB ASC paragraph 305-10-20 (US GAAP).

The ACT plans to issue guidance by way of webinars and a briefing note on the upcoming changes.

{ ONE TO WATCH }

SWIFT v RIPPLE – CROSS-BORDER PAYMENTS

One possible practical application of blockchain technology has been identified as payments – specifically, cross-border payments. Currently, there are two principle approaches being taken: SWIFT gpi with a hyperledger protocol (a closed private blockchain), and Ripple with an interledger protocol (peer-to-peer with no central hub). There are pros and cons to both approaches, but, according to some, it's sizing up to be a rerun of the Betamax v VHS battle of the 1970s.