CBK LIBOR Transition - FAQ

1. What is LIBOR and how it works?

LIBOR stands for the London Interbank Offered Rate which is a benchmark interest rate calculated as an average of panel bank submissions and reflects the interest rate on unsecured interbank borrowings of these banks. LIBOR rates are published by its administrator, ICE Benchmark Administration (IBA), every applicable London business day across five currencies (British Pound Sterling, Euro, Japanese Yen, Swiss Franc and US Dollar) and seven tenors (overnight, 1 week, 1, 2, 3, 6 and 12 months).

2. Why is a transition away from LIBOR being considered?

The key deficiency of LIBOR is that it is based on unsecured transactions in the interbank funding markets that have significantly diminished in volume since the 2008 financial crisis e.g. in one Libor currency/tenor combination the dozen panel banks submitting rate information executed just 15 transactions between them for an entire year.

This lack of liquidity has resulted in LIBOR significantly relying on "expert judgement" by panel banks. Cases of attempted market manipulation and false reporting have been observed and have undermined confidence in the reliability and robustness of existing interbank benchmark interest rates.

Despite improvement made by the IBA and the panel banks on the submitting process, these could not address the absence of an active underlying market. Panel banks have become reluctant to continue making LIBOR submissions and as such the UK's Financial Conduct Authority (FCA) concluded that LIBOR was potentially unsustainable and announced in July 2017 that it would no longer compel panel banks to provide LIBOR submissions beyond the end of 2021.

3. When will the LIBOR transition take effect?

On 5 March 2021 , the FCA announced it will not compel IBA to publish LIBOR and thus, all LIBOR settings will either cease to be provided by any administrator or no longer be representative:

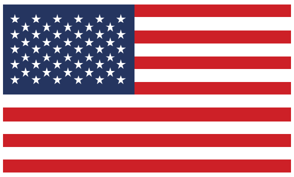
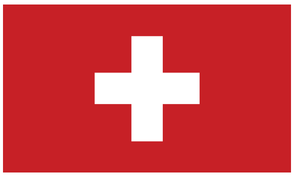
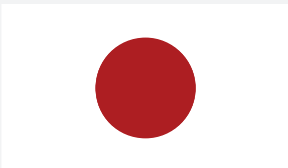
- immediately after 31 December 2021, in the case of all Sterling, Euro, Swiss Franc and Japanese Yen settings, and the 1-week and 2-month US dollar settings; and
- immediately after 30 June 2023, in the case of the remaining US dollar settings

While for the key USD LIBOR tenors the publication of LIBOR rates has been extended to 30 June 2023, the availability of these only relates to legacy contracts and thus any new contracts entered into after 31 December 2021, should make no reference to any LIBOR rate.

4. What rates will replace LIBOR?

Each of the major jurisdictions (the US, the UK, Switzerland, Japan and the Eurozone) have identified alternative reference rates, also known as Alternative Risk-Free Rates (ARFRs). These new rates are all overnight rates and are based on highly liquid underlying markets. The table below summarizes the selected ARFRs across each LIBOR currency with the relevant administrators of these.

[1] https://www.fca.org.uk/news/speeches/the-future-of-libor
[2] https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf

REGION	RATE	ADMINISTRATOR
	Sterling Overnight Index Average **(SONIA)**	Bank of England (BoE)
	Secured Overnight Financing Rate **(SOFR)**	Federal Reserve Bank of New York
	Euro Short-Term Rate **(€STR)**	European Central Bank (ECB)
	Swiss Average Rate Overnight **(SARON)**	SIX Swiss Exchange
	Tokyo Overnight Average Rate **(TONA)**	Bank of Japan (BoJ)

5. Where can I find more information on Alternative Risk-Free Rates (ARFR)?

Each of the ARFR working groups mentioned above have set up websites to provide market participants with relevant guidance and recommendations in order to limit their legal, conduct, operational, and financial risks and support a timely and smooth transition to the new rates. Please see below websites for further information.

Currency	Working Groups Websites
GBP	www.bankofengland.co.uk
EUR	www.ecb.europa.eu
USD	www.newyorkfed.org
JPY	www.boj.or.jp
CHF	www.snb.ch

CBK LIBOR Transition - FAQ

6. How are ARFRs different from LIBOR?

LIBOR rates are all forward-looking, that is the rate to paid at the end of the interest period is known at the beginning of the period. On the other hand, since all ARFRs are overnight rates, the alternative rates are backward looking rates where the interest is not known until the end of the period and can be calculated with a number of methods, most commonly the compounding in arrears method. Similarly, since all ARFRs are overnight rates they are considered near risk-free and, as such, unlike LIBOR, don't price any term and interbank risk.

7. What is a Credit Adjustment Spread (CAS) and why is it needed?

As noted above, the overnight ARFRs are nearly risk-free whereas the relevant IBORs incorporate a bank credit risk premium and liquidity factors. Consequently, ARFRs are typically lower than LIBOR. To account for this economic difference, an adjustment spread is usually applied to the compounded ARFR, called the credit adjustment spread (CAS).

8. What are the key risks of transition from LIBOR to ARFRs? What are the likely impacts?

ARFRs are calculated on a different basis to LIBOR. This creates numerous challenges at operational, financial and contractual level for impacted market participants

- Existing systems and processes may not be able to support the new rates and thus limit the organisation's ability to operationally support the transition.
- Risk that on the time of transition the new rates would be different than LIBOR that will have an impact on the market valuation of each impacted financial instruments
- Existing contracts may not have the appropriate mechanism embedded to transition to the new rates seamlessly that might cause contracts to be frustrated

The transition from LIBOR is expected to impact a number of our existing and future transactions across multiple contract types and client segments including private and corporate loans. We are thus assessing the impact on the LIBOR linked transactions and products to be able to provide comprehensive guidance and suggestions to our clients. At the same time, we are closely monitoring market developments and considering what options can be made available for you.

We recommend that you stay engaged with the transition and consider the potential impact on the products you hold with us.

9. Do the proposed changes only impact LIBOR?

This transformation does not relate only to LIBOR; in fact many other jurisdictions are considering alternatives to their interbank offer rates (IBORs).

These include benchmarks such as EURIBOR and EONIA for EUR, the Tokyo Interbank Offered Rate (TIBOR) for JPY, the Hong Kong Interbank Offered Rate (HIBOR) for Hong Kong Dollar and the Singapore Interbank Offered Rate (SIBOR) for Singapore Dollar.

CBK LIBOR Transition - FAQ

10. What transactions are likely to be impacted?

Transition will affect both new and existing products linked to LIBOR settings

- **Legacy transactions referencing LIBOR with a legal maturity beyond the relevant cessation dates:** Any existing transaction should either include robust fallback mechanism to ensure a seamless transition to the new rates or will need to be actively transitioned to the new rates prior to the cessation dates.

These provisions were typically designed to address a temporary disruption to LIBOR rather than a permanent cessation. Therefore, the contract provisions need to be amended in order to reflect robust fallback language and migrate to new ARRs before the relevant cessation dates.

- **New transactions:** In order to facilitate an orderly transition, the relevant jurisdictional regulators have strongly encouraged banks to cease entering into new LIBOR contracts. Most importantly the Federal Reserve has noted the 31st of December 2021 as the final date where new LIBOR contracts would be entered into. Additionally, any new transactions entered into before the above set date and mature beyond 2021, should have in place robust fallback language to ensure a continuation of the transaction.

11. What is fallback language?

Fallback language refers to the legal provisions in a contract that apply if the underlying reference rate in the product (e.g. LIBOR), is discontinued or is unavailable.

In addition to identifying impacted agreements, organisations need to evaluate whether these agreements contain robust fallback provisions. Since few market participants anticipated the permanent cessation of LIBOR, robust fallback provisions were not embedded in contracts.

A robust fallback language need to clearly specify (i) the trigger events for a transition to a replacement rate, (ii) the replacement rate, and (iii) the spread adjustment to align the replacement rate with the benchmark being replaced. Different groups and international bodies have published recommended fallback language provisions to be incorporated in the various contracts, most notably:

- For OTC derivatives, the ISDA IBOR Fallbacks Supplement and Protocol was published (refer to point 13)

- For USD LIBOR linked contracts the Alternative Reference Rates Committee (ARRC) published recommended fallback language provisions across different types of contracts.

12. What will happen if my contracts do not contain robust fallback language when LIBOR ceases?

Robust fallback language is required in financial contracts to enable a smooth transition in the event of a benchmark cessation event. The cessation of LIBOR after the end of 2021 and June 30, 2023 for major USD LIBOR settings, might risk the viability of the contract if no robust fallback language is in place.

CBK is currently reviewing all LIBOR linked contracts and will contact you if robust fallback language needs to be incorporated.

[3] Federal Reserve - Statement on LIBOR Transition - November 30, 2020
[4] https://www.isda.org/2020/10/23/isda-launches-ibor-fallbacks-supplement-and-protocol/
[5] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-July-9-2018-announcement

13. What are some of the considerations for derivatives referencing LIBOR and what is the recommended fallback language?

Similar to other contract agreements, a typical derivative master agreement will currently include "fallback" language which specifies what happens in an event that the rate they reference is not available. However, the specific fallback provisions do not cover a scenario of a permanent cessation of the interbank borrowing rate. To accommodate for the problem the ISDA IBOR Fallbacks Supplement and Protocol was published on 23 October 2020 that provides a key mechanism for incorporating fallback language in derivative contracts. The Protocol became effective on January 25 2021 and for the protocol to be effective on a specified derivative contract, both counterparties would need to adhere to the protocol.

14. CBK has adhered to ISDA's IBOR Fallbacks Protocol. What does this mean?

ISDA's IBOR Fallbacks protocol is an addendum to existing ISDA agreements that prescribes how derivatives will fallback to the ARFRs. This includes both identification of the replacement rates as well as the spread adjustment that will be incorporated in the final contract rates. If both parties to an ISDA Master agreement adhere to the protocol, that means they agree for that for all derivative contracts under this Master agreement, there exist an automatic mechanism where on the LIBOR cessation dates, the derivative contracts will switch the new rates.

Following the announcement made by FCA on 5 March 2021 , the International Swaps and Derivatives Association (ISDA) has followed up noting that this announcement constitutes an index cessation event under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings. As a result the credit adjustment spreads to be used in its suggested fallback language (refer to point 11 above), are now fixed for all Sterling, Euro, Swiss franc, US dollar and Japanese yen LIBOR settings. ISDA has selected Bloomberg to publish these spread adjustments and these have already been calculated and published.

15. What are some of the considerations for loans referencing LIBOR and what is the recommended fallback language?

Standard contractual agreements for loans usually includes fallbacks intended to apply when the loan referenced rate becomes unavailable. However, as with derivatives, this language might not fully contemplate a permanent cessation of the benchmark.

The big challenge for loan agreements is that they are not standardized but rather vary in terms and documentation. As such, there is not a single protocol mechanism available to amend existing, or legacy, contracts. Different industry bodies have been active in proposing amendments and recommending appropriate fallback language provisions to be incorporated in the various contracts.

Due to the different provisions available, the ultimate outcome will be a result of (i) suggested fallback provisions and (ii) negotiations between the different counterparties.

[6] https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf
[7] ISDA fixed spread adjustments

CBK LIBOR Transition - FAQ

16. Will the transition lead to changes on other terms in the loan document change as a result of LIBOR transition?

Other than fallback provisions, loan documents may also contain other operational, technical or administrative provisions that may be impacted by the transition. These contract changes are also likely to include changes in interest rate terms and credit spreads to account for the key differences between ARFRs and LIBOR.

17. What is CBK doing to get ready for the transition?

CBK has established a LIBOR transition programme, which is responsible for coordinating and directing the actions of the Bank in migrating away from LIBOR-based product pricing. The programme affects all aspects of CBK's businesses. We have currently assessed the impact that the transition will have on our LIBOR-linked transactions and products and have initiated a process to update our systems and processes to support the new rates.

18. Do clients need to do anything now?

We recommend that you periodically monitor the news emerging from the relevant trade bodies and consider the potential impact on your products and to review the provisions set in your existing contracts to identify LIBORs related transactions.

Clients are also advised to identify their exposures and the relevant contracts for fallback language.

19. Where can I find more information?

Regulators, industry bodies and other related institutions and regulatory bodies where you can find more information.

Body	Link
FCA	https://www.fca.org.uk/markets/libor
FSMA	https://www.fsma.be/en
ESMA	https://www.esma.europa.eu/policy-rules/benchmarks
IOSCO	https://www.iosco.org/
FSB	https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/financial-benchmarks/
FCA	https://www.fca.org.uk/markets/libor
FSMA	https://www.fsma.be/en
ISDA	https://www.isda.org/ https://www.isda.org/category/legal/benchmarks/
ICMA	https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/benchmark-reform/
LMA	https://www.lma.eu.com/libor

CBK LIBOR Transition - FAQ

Further information

- For more information, please get in touch with your usual CBK contact.

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