ICMA – Market Report
Asia Securities Forum Annual General Meeting

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Overview of ICMA

- The International Capital Market Association (ICMA) is a non-profit membership association representing both the buy side and sell side of the industry.
- ICMA's membership includes issuers, intermediaries, investors and capital market infrastructure providers.
- ICMA has more than 580 members located in over 60 countries worldwide.
- ICMA's mission is to promote resilient and well functioning international debt capital markets.
- The four main pillars of ICMA's work are:
  - Primary bond markets
  - Secondary bond markets
  - Repo and collateral
  - Green, social, and sustainable finance
- ICMA works with its members to create market best practice and documentation:
  - Primary Dealers Handbook
  - Secondary Market Rules and Recommendations
  - Guide to Best Practice in the Repo Market
  - Global Master Repurchase Agreement (GMRA)

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Benchmark transition

This presentation will cover:

- The problem with the IBORs
- The adoption of risk-free rates in the FRN/bonds market
- New contracts referencing IBORs: fallbacks
- The conversion of legacy bonds

The problem with the IBORs

- The Chief Executive of the UK Financial Conduct Authority (FCA) has said that the FCA would no longer intend to use its powers to persuade or compel banks to submit contributions for LIBOR after the end of 2021

"LIBOR is meant to measure the short-term unsecured funding costs of banks. But the reality is that, since the financial crisis, LIBOR really has become the rate at which banks do not lend to each other. Bank funding markets have changed enormously."

– Bank of England

"Inherent fragility of its 'inverted pyramid', where the pricing of hundreds of trillions of dollars of financial instruments rests on the expert judgment of relatively few individuals, informed by a very small base of unsecured interbank transactions"

– US Federal Reserve

"The globally most relevant interbank interest rates benchmarks, like LIBOR and EURIBOR, were unregulated and their methodologies and governance allowed manipulation on a scale rarely seen in the financial sector."

– ESMA

The scale of the problem

LIBOR and other IBORs are embedded across the global financial system.

The outstanding notional value has been estimated as at least:

- GBP LIBOR: $30 trillion;
- USD LIBOR: $150 trillion;
- EURIBOR: $150 trillion;
- Euro LIBOR: $2 trillion
- CHF LIBOR: $6.5 trillion;
- JPY LIBOR and TIBOR: $35 trillion.[1]

Derivatives are estimated to represent around 80% of financial contracts referencing LIBOR by notional value, but cash products (such as loans and bonds) referencing LIBOR are substantial as well.

[1]Quoted in IBOR Global Benchmark Survey 2018 Transition Roadmap: ISDA, AFME, ICMA, SIFMA and SIFMA Asset Management Group

The adoption of risk-free rates in the bond market

Progress is already being made with the adoption of new RFR’s in bond markets:

GB Pound (sterling)

- Over £30 billion of SONIA FRNs. Issuance of LIBOR transactions has all but ceased
- Issuers have mainly been SSAs, banks and building societies, with a broadening base of investors
- All 40+ transactions have used the same market conventions - SONIA compounded over the interest period in arrear

US Dollar

- Over US$40 billion of SOFR FRNs have been issued
- Issuers mainly SSA’s, financial institutions
- Conventions are evolving

New contracts referencing IBORs : fallbacks

There has been strong messaging from the official sector in the US and the UK to cease writing any new LIBOR-referencing business

- If this is not possible, any *new contracts* referencing LIBOR and maturing beyond 2021 should contain robust fallbacks to risk-free rates (see also the EU Benchmark Regulation Article 28(2) requiring "*robust written plans*" in relation to the cessation of a benchmark)
- In the UK, issuers have included alternative fallbacks language to address a permanent cessation of IBORs since mid-2017. This is typically benchmark and currency agnostic and negotiated on a case-by-case basis
- However GBP LIBOR-referencing transactions have all but ceased
- In the US, the ARRC (*Alternative Reference Rates Committee*) has produced fallback language for new USD LIBOR FRN contracts – this hardwires a waterfall of fallbacks

The conversion of legacy bonds

Legacy bonds referencing LIBOR are due to mature beyond the end of 2021, when LIBOR may no longer be available.

- By way of illustration, it has been estimated that the global total of legacy bonds referencing LIBOR with a maturity beyond the end of 2021 is at least *US$864 billion* equivalent.
- Around 80% of that total references USD-LIBOR
- If LIBOR is discontinued, many legacy bonds will *fall back to a fixed rate* based on the fallbacks drafted into the documentation at a time when permanent discontinuation of the rate would not have been anticipated
- This is unlikely to be aligned with the commercial intention of the counterparties

Amending legacy bonds

- Unlike derivatives, bonds are contracts between multiple parties and are freely tradeable, meaning the identity of the parties can change
- Bonds cannot be amended by way of adherence to an industry protocol
- Bonds usually contain provisions allowing the terms of the contract to be amended - this requires consent from bondholders.
- Depending on the governing law of the bond and relevant market practice, the consent threshold may be high (e.g. 75% under English law, and 100% under NY law)
- Amending bonds by way of consent solicitation is often time-consuming and administratively burdensome for issuers and bondholders. It is a voluntary process and there is no guarantee of success

Consent solicitation in practice

- In the UK, *Associated British Ports* (ABP) have undertaken a consent solicitation exercise to amend a series GBP LIBOR FRNs to SONIA plus a fixed spread
- The success of this trade is not necessarily indicative of future success for other transactions; for example, bank capital securities may be more difficult to amend
- We are starting to see other issuers engage in discussions with bondholders regarding amending outstanding securities

Options for legacy LIBOR bonds

Other options for legacy LIBOR bonds include:

- Buy-backs or other **liability management exercises**
- **Continue publication of an "unrepresentative" LIBOR** in some form?
- **Allowing existing fallbacks to operate** without amendment (as a result of which, many FRNs will become fixed rate)

Thank you

Questions?

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