LIBOR transition: are you ready?

31 December 2021

Background

- Interbank Offered Rates (IBORs) play an integral role in the global financial markets. In the aftermath of the financial crisis, their reliability and robustness were undermined by alleged manipulation.
- Since then the official sector and market participants have undertaken a series of initiatives to restore the governance and oversight of major interest rate benchmarks.
- Through various working groups steps have been taken to reform existing rates and prepare for a transition to alternative reference rates (ARRs), in most instances risk-free rates (RFRs).
- On March 5, 2021 the UK Financial Conduct Authority (FCA) confirmed the cessation or loss of representativeness of all 35 LIBOR (London Interbank Offered Rate) settings currently published.
- In the case of all GBP, EUR, CHF, JPY and the 1-week and 2-month USD settings this will be immediately after December 31, 2021. In the case of the remaining USD settings this will be immediately after June 30, 2023.
- After the end of 2021 no LIBOR will be available for use in new (re)financing contracts. Pending future consultations, any use of 'synthetic' LIBOR for existing exposures after December 31, 2021, is expected to be restricted to a very narrow set of contracts.

Why is this important?

- With less than 200 days to go until the cessation or loss of representativeness of LIBOR, it's time to take action.
- If the transition is given timely and proper attention, costs can be contained, control maintained and uncertainty avoided while strengthening relationships with stakeholders.

Key challenges

Legal (HVG Law)

- All contracts referencing LIBOR rates are impacted and might need to be amended and/or re-negotiated (e.g. ISDA, cash pooling, intercompany loans, lease agreements, supplier contracts) to include adequate fallback provisions.
- New contracts to make reference to appropriate benchmark rates providing for necessary contractual flexibility.

Transfer pricing and tax

- Disruption in the TP policies for intra-group financing (including loans, cash pool, current account, and in-house bank structures) where rates are heavily reliant on LIBOR market convention.
- TP benchmarks and documentation need to be updated to reflect new RFRs / ARRs, to ensure arm's length pricing.
- Advance tax rulings addressing intra-group financing transactions may need to be amended, too.
- Book value of debt instruments and certain other assets and liabilities may potentially change – impact on current and deferred taxes incl. correct distinction between P/L and Equity (OCI) impacts to be analysed.

Treasury

- Change in pricing methods for banking products (e.g. derivatives, cash pools).
- Funding strategies uncertain with regard to variable financing based on LIBOR impacting asset and liability management.
- Supplier financing contracts and working capital programs to be re-negotiated and re-priced.

Technology

- Treasury and treasury related systems capturing market data and financial products need to be adapted in time to avoid substantial manual workarounds.

What should I do?

1. Make an inventory of existing (financing) contracts which reference LIBOR and expire after 2021
2. Assess if contracts include proper fallback language and/or amendments are required
3. Determine Alternative Reference Rates and (if applicable) spreads
4. Conduct impact and risk assessment to identify impacted areas, processes and systems, prioritize
5. New financing contracts should either use ARRs from the outset or include proper fallback language

Existing arrangements (1–4)

New arrangements (5)

> “With the cessation or loss of representativeness of LIBOR at the end of 2021, advanced planning from a legal, transfer pricing, tax and treasury perspective is key to ensure a smooth transition.

Examples of impacted transactions

- loan and facility agreements
- interest rate swaps, options, forwards and other derivatives
- cash pooling agreements
- overdraft facilities
- bonds and other marketable securities
- factoring and guarantees

For further information, please contact

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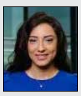

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