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Important Notice to Customers

中国建设银行(亞洲) China Construction Bank (Asia)

Frequently Asked Questions of IBOR Reforms

*Despite the wide application of Interbank Offered Rate (**IBOR**) in the financial contracts, the current mechanism of determining interbank offered rates has long been criticised as inadequate and inherently subject to subjectivity due to its heavy reliance on "expert judgement" during the submission of the quotes by the panel banks. As part of the global reform initiative to improve robustness of the financial benchmarks, the supervisory authority of LIBOR, UK Financial Conduct Authority (FCA), on 5 March 2021, has announced that all LIBOR settings will either cease to be provided by any administrator or no longer be representative:*

- *31 December 2021 – for all Sterling (GBP), Euro (EUR), Swiss Franc (CHF) and Japanese Yen (JPY settings, and the 1-week and 2-month US Dollar (USD) settings; and*
- *30 June 2023 – for the remaining USD settings (i.e. USD overnight, 1-month, 3-month, 6-month and 12-month)*

Regulators across the globe have been releasing guidance asking banks in each jurisdiction with financial products and contracts that references LIBOR to take action and transit away to more robust and reliably determined alternative reference rates (ARR). As such, banks with exposures across UK, US, EU and Hong Kong jurisdictions are now acting to phase out the use of LIBOR and use ARR as a replacement for existing and new products and contracts, prior to the end of 2021, to avoid any market disruption. In particular, the Hong Kong Monetary Authority (HKMA) has released its expectations on banks to cease new LIBOR-linked contracts by end of 2021.

1. What are the new ARRs that will be replacing LIBOR?

In the five LIBOR currency areas (i.e. the US, Euro Zone, Japan, the UK and Switzerland), relevant authorities have identified transaction based overnight interest rates as the alternative reference rates （ARRs） for LIBOR. The reform requires the replacement of IBOR for each relevant currency by new ARRs. ARRs will be determined for different currency exposures and based on market transactions and valuations.

The table below summarises LIBOR to be replaced by ARRs:

Currency	LIBOR	ARR	Regulator
USD	USD LIBOR	Secured Overnight Financing Rate (SOFR)	Federal Reserve Bank of New York
EUR	EUR LIBOR	Euro Short Term Rate (ESTR)	European Central Bank
GBP	GBP LIBOR	Sterling Overnight Index Average (SONIA)	Bank of England
CHF	CHF LIBOR	Swiss Average Rate Overnight (SARON)	Swiss National Bank
JPY	JPY LIBOR	Tokyo Overnight Average (TONA)	Bank of Japan

2. What about HIBOR? Will HIBOR be discontinued?

In Hong Kong, there is no plan to discontinue HIBOR yet as it remains a credible financial benchmark according to Treasury Markets Association (TMA). Nonetheless, in alignment with the international trend, the market has identified HKD Overnight Index Average (HONIA) as the ARR for HIBOR.

While HONIA serves as an alternative to HIBOR, it is expected that HONIA and HIBOR will co-exist in the market and market participants are free to choose between them. While market participants may continue to use HIBOR as the benchmark rate for their financial products, they are however encouraged to start incorporating HONIA into their business.

3. How are these ARRs different from IBORs?

Compared to IBOR where an active underlying market is absent and is only backed by limited underpinning transactions, ARRs are more transparent as they are based on real transaction data in active markets, and are almost overnight risk-free reference rate (RFR) with close correlation with other money market rates, which makes them less vulnerable to manipulation and form a more reliable basis for all financial contracts relying on a reference rate.

However, given the nature of ARRs where it's based on historical transaction data, ARRs are backward-looking rates instead of forward-looking rates as if IBORs are. This implies that ARRs may not have a term structure like IBOR (e.g. 1 month, 3-month, 12-month LIBOR etc.) which can be used to determine the future interest for different period based short term contracts.

4. How can these ARR be used in financial transactions given that no term structure is available like LIBOR?

Certain overseas authorities have been actively exploring the possibility of deriving a term structure for these overnight rates. The Alternative Reference Rates Committee (ARRC) has announced its target of developing term reference rate based on the SOFR derivatives markets, and recommended Banks to use SOFR as the preferred ARR of USD denominated LIBOR contracts.

However, a firm timetable for doing this has yet to be established. Regulatory authorities expect the market to move to calculating interest on compounding in arrears basis and market participants should not wait for term rates to be available before transitioning to ARRs. Customers are therefore advised to rely on calculation methods that have already been developed in the market and promptly consult the Bank on the preparations required for the transition.

5. What are the implications of LIBOR reform to me?

The reform may impact certain products, services and contracts that you are currently using and what we can offer in the future (e.g. loan, derivatives, bonds, structured products, etc.). Impact may include replacement of existing/referencing new interest rate benchmark in contractual documentations, changes in the calculation methodology for interest payments, valuation of products, etc. The extent of these impacts will however depend on a range of factors such as regulatory or industry working group initiatives and preferences, the underlying interest benchmark used in existing positions, and the market timeline for IBOR cessation and ARR transition. As such, the extent of impact may vary from person to person.

Nonetheless, all of the LIBOR-linked exposures and contracts will be impacted by the discontinuation of LIBOR and will have to be transitioned to ARRs in due course. Customers with existing LIBOR contracts may find that such contracts do not stipulate how contract terms would be managed should LIBOR become permanently unavailable. These contracts could be subject to potential dispute or litigation if the parties to the contract fail to agree on a replacement rate in advance and need to be amended. Legacy and new contracts will have to incorporate sufficient fallback language [1] in preparation for the cessation of LIBOR by end of 2021/ 30 June 2023[2].

If you have exposures and contracts that reference LIBOR and mature after end of 2021/ 30 June 2023[3], we will be or are already contacting you soon to negotiate new contract arrangements and assist in your transition.

6. What are you doing for me?

Some industry working groups have been working closely with market participants in the development of legacy products and contract amendment. We note there is an industry effort in standardizing the fallback language, interest calculation conventions for new ARR products. We are actively participating in such industry discussions and monitoring these developments to ensure that measures to be adopted by us are in line with market and industry practices.

Depending on the type of product or contracts involved, we will reach out to the impacted customers by batches to inform of the changes and actions to be taken arising from the LIBOR transition initiative. We will assist you in assessing the adequacy of amendment provisions contained in the relevant credit documentations and will revise the documentations to incorporate fallback provisions as needed, though it should be noted that fallbacks may vary across different product types and the timeline for finalization of the provisions will be dependent on market timeline as well. We will also ensure that such new ARR and fallbacks will have been included in all new financial contracts and related documentation.

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[1] Fallback language refers to the legal provisions in a contract which will be applied if the interest reference rate of a product is discontinued, and consists of a conditional trigger event and a replacement rate for the said trigger event.

[2,3] The cessation date may differ between different LIBOR settings. For further details of the cessation date of each LIBOR setting, please refer to the timeline in the first paragraph of this document.

We will continue to share with you the latest developments and will supplement more detailed information to impacted customers once there is more visibility in the industry and market on the benchmark rates and methodologies adopted.

7. What do I need to do now? How do I prepare for IBOR reform?

All customers (including corporate and retail customers etc.) should take steps to identify and review all their existing investments and contracts that use LIBOR as the reference rate (e.g. bilateral and syndication loans, derivatives, floating rate notes, etc.). If the contracts do not contain provisions setting out how LIBOR will be replaced when it becomes unavailable, you should talk to your banks and counterparties to build in the alternative reference rates as a fallback. You should also reduce new LIBOR investments and exposures, and avoid entering into new contracts with a maturity beyond 2021 using LIBOR as reference rates.

You should be aware of the adequacy of communication and disclosures provided during renewal of legacy contracts or new contracts. While the Bank will make all effort to ensure that the aforementioned concerns are thoroughly covered during our communication with you, we suggest customers to also conduct your own independent assessment on the potential consequences brought about to your business/ personal investments by transiting to a new ARR e.g. changes in accounting treatments, IT or process changes required, etc.

We encourage you to keep up to date with the latest market developments and follow the progress of product offerings referencing ARRs. For specific questions on your existing LIBOR contracts and how these should be handled, please contact your Relationship Manager, and seek advice from lawyers or professional advisors on possible implications from a legal/ financial/ tax/ IT and/or operations perspective as you consider how to prepare for transition.

For enquiries, please click here to contact us or visit our website at www.asia.ccb.com.

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