THIS MONTH

THE LIBOR PROBLEM

This month's briefing makes no reference to Brexit for two related reasons: firstly (and possibly very depressingly), although we are 12 months on from the referendum, there are still more questions than answers. But we hope that by the time you read this in July, things are moving at such a pace that anything we could have written in late June is out of date. Instead, we choose to focus on things you can do something about – possibly!


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 }

HOW DO YOU SOLVE A PROBLEM LIKE LIBOR?

While undoubtedly a slow-burn issue, benchmarks reform is proving complex.

Any evolution of benchmark rates will be glacial, as it is likely to take years to develop liquidity in markets referencing any new rate. Nevertheless, central banks across the globe are exploring alternatives and treasurers would do well to be prepared.

Let's start with some background. The London Interbank Offered Rate (Libor) began life in the 1970s as the rate at which banks would lend to each other. Initially, it was also used as a reference rate for corporate bank loans. In the 1980s, Libor became an average rate of a group of banks and, with the development of the derivatives market, became very widely used so that, today, every treasurer will casually refer to Libor and expect to see it in financial contracts (both debt and derivatives). Many commercial contracts will also reference Libor, particularly in non-performance clauses.

However, events have not run smoothly and today Libor faces two challenges:

- Loss of confidence: widespread rate manipulation in recent years has resulted in a loss of confidence in Libor as a benchmark.
- Lack of liquidity: worldwide banking reform and regulations arising from the global financial crisis have resulted in fewer interbank short-term loans and reduced demand for bank debt. Libor (particularly the longer maturities) is increasingly an estimated rate rather than one based on actual transactions, due to insufficient data.

In response, the ICE Benchmark Administration (IBA), which oversees Libor, and the European Money Markets Institute (EMMI), which oversees Euribor, have developed and implemented reforms designed to restore confidence and credibility in interbank offered rates. There is a strong groundswell in favour of retaining Libor (in name, even if how it is calculated makes it virtually unrecognisable) as the possible consequences of Libor as a reference rate disappearing are alarming to many and include:

- What would a new benchmark mean for financial (and non-financial) contracts? The disappearance of Libor wouldn't purely be a treasury problem. In the case of short-term contracts, one might be relatively sanguine, but what about 30-year floating-rate debt?
- What are the cost implications of transitioning from one reference rate to another (just managing the process of transitioning swaps and underlying to minimise fixing mismatch will be time-consuming and complicated)?
- Who even wants to contemplate the hedge-accounting issues if mandatory redesignation is deemed to trigger a break in the hedge?

(As an aside, mandatory novation and the resulting impact on hedge accounting under IFRS 9 is something you might want to think about as your banks talk to you about contract novation as a result of bank restructuring or ring-fencing.)

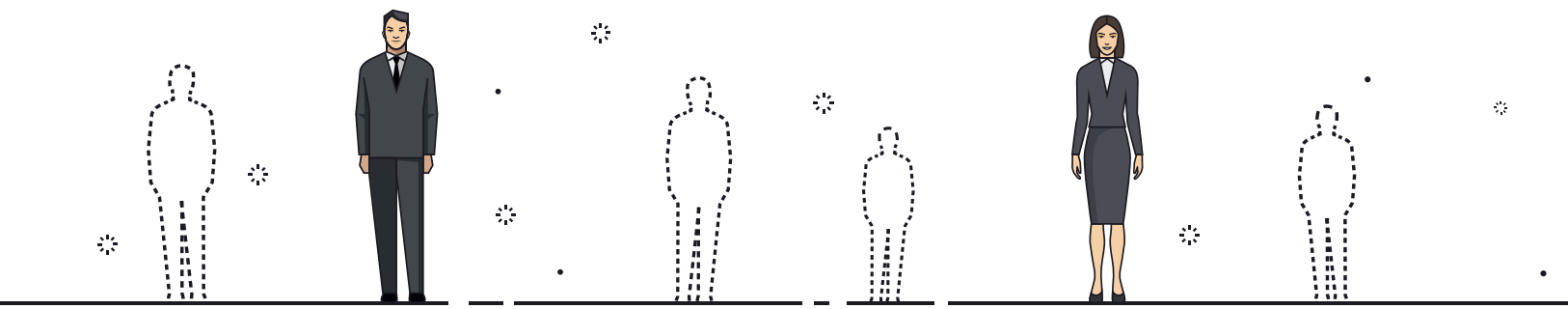
Despite the challenges, a number of central banks have identified the fragility of Libor as a key risk to market stability and have decided to develop alternative benchmark rates. In most cases, the suggestion is some form of near-risk-free overnight rate, which works in principle, but fails to address the part of the market in which corporates arguably have most interest – namely, three- and six-month fixings.

In the UK, the proposal is that the Sterling Overnight Index Average (SONIA) rate could be used as an alternative to Libor; in Japan TONAR (Tokyo Overnight Average Rate); and in Switzerland SARON (Swiss Average Rate Overnight). In May, the European Central Bank said it would consider adopting a similar approach.

At the end of June, the US announced that it planned to adopt a slightly different approach by selecting a rate based on overnight lending in the US repo market.

In her keynote speech at the Bank of England briefing for corporates on the new codes of best practice in June, Sarah John, head of sterling markets, encouraged corporates to get involved with the development of a reformed SONIA benchmark. If any reader would like to contribute to the debate about benchmarks, please contact the ACT team at the email address above.

Benchmarks are definitely one to watch.



NEW ON THE WEB

EACT response to fintech consultation

In June, the EACT submitted a response to the European Commission on fintech with particular emphasis on the perspective of the corporate treasurer. Read the submission at www.eact.eu/wordpress/wp-content/uploads/2017/06/EACT_Response_EC_FinTech_consultation__15-June-2017.pdf

In codes we trust: the FX Global Code and UK Money Markets Code

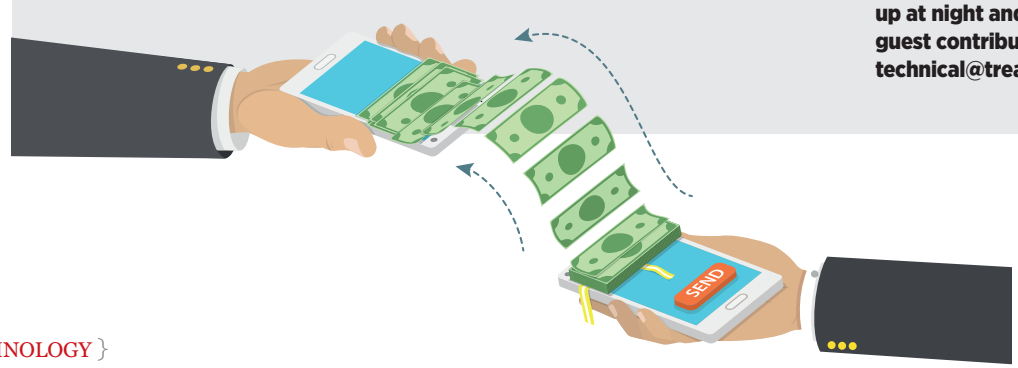
The codes' launch was celebrated at a very successful event hosted by the Bank of England for the ACT. The voluntary codes set out standards of best practice and we encourage all members to adopt them.

The ACT now has a web page dedicated to related resources at: www.treasurers.org/technical/codes

View briefing notes, technical updates and policy submissions at www.treasurers.org/technical. Members can find our library of Brexit-related resources at www.treasurers.org/brexit

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

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



{ TECHNOLOGY }

FASTER PAYMENTS – ROLLING OUT

As societies become instant, the payments industry is not far behind. Europe is preparing for the launch of the SEPA Instant Credit Transfer scheme on 21 November 2017. The scheme will allow euro-denominated pan-European payments of up to €15,000 to be available in the account of the beneficiary within 10 seconds.

Meanwhile, Australia is currently developing a similar platform with real-time clearing and settlement called the New Payments Platform (NPP). The NPP is the Australian equivalent of the UK's Faster Payments Service, but without the restrictive remittance information. Instead, NPP will offer the ability to include more information with payments, such as text or links to externally hosted documents.

{ INTERNATIONAL }

Turkey – compulsory FX hedging

For those treasurers with business (and foreign-denominated debt) in Turkey, Bloomberg has recently reported an interesting potential development.

It has been suggested that the central government may require companies to hedge the FX risk of any debt issued in any currency other than Turkish lira (TRY) if they have issued more than $15m.

This appears to be driven by two key considerations:

- The Turkish economy is heavily reliant on external funding, with an estimated $300bn in foreign-currency debt owed by private companies.
- The lira was one of the weakest emerging-market currencies in 2016, falling to a record low in January 2017 (USD/TRY 3.8 compared with USD/TRY 1.15 five years earlier).

The combination of these two factors could leave the Turkish economy very vulnerable in periods of currency volatility.

Based on data collated by Turkish regulators, it is estimated that the mandate would impact approximately 2,000 private companies (representing approximately 80% of FX debt).

Separately, there is also a proposal for smaller companies to have their FX credit lines limited to the size of their FX revenues, which would impact close to 20,000 companies.

Bank resolution in practice

The recent acquisition of Banco Popular by Santander in Spain for €1 demonstrated how the bank resolution procedure designed by the European Central Bank can work to avoid government bail-in.