# IBOR / RFR Transition FAQs

**Important Information: The following explanation of the IBOR RFR transition is provided for information purposes only. This information is not advice or a recommendation for any particular course of action, and no decisions should be made in respect of this information. No representations are made as to the information's completeness, accuracy or suitability for any purpose. Recipients should take professional advice before taking any action.**

### Preparing for Transition from IBORs to Risk Free Rates

Interest rate benchmarks based on interbank offered rates ("IBORs"), the interest rates at which banks lend to and borrow from one another in the interbank market, are in the process of being reformed. There are a number of IBORs that are widely used in the financial markets including the London Interbank Offered Rate ("LIBOR").

Public authorities, in both the UK and internationally, have been clear that LIBOR is expected to cease to exist after the end of 2021. Working groups have been set up in many different jurisdictions and alternative risk-free rates (RFRs) have been selected for all major currencies. RFRs are (near) risk-free rates calculated based on market transactions under the supervision of the relevant national regulator.

### 1. What is IBOR Transition and why is it happening?

Since 2014, concerns have been expressed by the global financial regulatory authorities surrounding the transparency and robustness of existing market benchmark rates (InterBank Offer Rates - IBORs). In 2017, both the FCA and the Bank of England noted the absence of active underlying markets and the scarcity of underpinning transactions raised serious questions about the future sustainability of the London InterBank Offer Rate (LIBOR) benchmarks. Without sufficient transactional data, LIBOR submissions made by banks to represent the LIBOR rate are increasingly based on expert judgement of panel banks rather than actual transactions, which heightens the risk of benchmark manipulation. Risk Free Rates (RFRs), on the other hand, are based on liquid overnight money markets deals, to which the Central Banks have oversight.

Regulatory authorities in major jurisdictions around the world have signalled their aim to substantially complete the transition (from IBORs to RFRs) process by the end of 2021. The FCA have also made it clear to all market participants that they need to have removed dependencies on LIBOR by this date. It has also been communicated to market participants to begin transitioning from the use of LIBOR to alternative benchmark rates as soon as possible, in order to avoid disruption when the publication of LIBOR ceases.

### 2. What is LIBOR?

The LIBORs are interest rate averages calculated for different currencies and maturities (tenors) from estimates submitted by a panel of banks in London. LIBOR rates are calculated for five currencies and seven maturities, ranging from overnight to 12 months, and are administered by ICE Benchmark Administration Limited (IBA), and regulated by the Financial Conduct Authority (FCA).

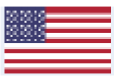
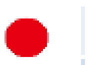
The rate is set based on daily submissions of quotes, by banks, of their expected wholesale funding rate for a given currency and tenor pair. For example, USD 3-month LIBOR is the trimmed mean of the rates submitted by the panel banks for what they believe it would cost for them to fund borrowing in USD for three months in London.

## 3. Which IBORs are impacted and what are the replacement benchmarks?

A risk-free rate (RFR) is a (near) risk-free rate that is calculated based on actual market transactions under the supervision of the relevant national regulator. To date, these rates have all been overnight rates, some based on secured funding rates, some unsecured.

The transition to alternative risk-free rates has a number of benefits. Risk-free rates are transparent; they are based on real transactions (as opposed to submissions, as is the case with most IBORs at the moment); they are difficult to manipulate, and they form a reliable basis for all types of financial contracts which rely on a reference rate. They are also seen as a more appropriate benchmark rate because they do not already incorporate the credit risk premium which is embedded in interbank offered rates.

Working groups have been set up in many different jurisdictions and alternative reference rates (ARRs) have been selected for all major currencies.

| Jurisdiction | IBOR | Working Group | Alternative Ref Rate | Rate Name | Administrator | Publication date | Description |
|---|---|---|---|---|---|---|---|
|  | GBP LIBOR | Working Group on Sterling Risk-Free Reference Rates | SONIA | Sterling Overnight Index Average | Bank of England | Reformed 23/04/2018 Legacy 31/03/1997 | Unsecured rate that covers overnight wholesale deposit transactions |
|  | USD LIBOR | Alternative Reference Rates Committee | SOFR | Secured Overnight Financing Rate | Federal Reserve Bank of New York | 02/04/2018 | Secured rate that covers multiple overnight repo market segments |
|  | CHF LIBOR | The National Working Group on CHF Reference Rates | SARON | Swiss Average Rate Overnight | SIX exchange | 22/09/2009 | Secured rate that reflects interest paid on interbank overnight repo |
|  | JPY LIBOR | Study Group on Risk-Free Reference Rates | TONAR | Tokyo Overnight Average Rate | Bank of Japan | 30/12/1992 | Unsecured rate that captures overnight call rate market |
|  | EONIA | Working Group on Risk-Free Reference Rates for the Euro Area | €STR | Euro Short Term Rate | European Central Bank | October 2019 | Unsecured rate that captures overnight wholesale deposit transactions |
| | EURIBOR | | EURIBOR Unlike other IBORs, EURIBOR has been reformed to be compliant as a benchmark rate on an ongoing basis. | | | | |

The latest Investment Association (IA) and Linklaters IBOR currency tracker shows the key jurisdictions and their IBOR transition approach and timeline.

If you have any questions about the RFR relevant to your jurisdiction please contact your usual Fidelity International contact or e-mail **FIL RFR Queries**.

**4. Who will be impacted by transition to RFR's?**

All financial market participants including retail customers, corporations, issuers, investors, asset managers, service providers of financial products, and large financial institutions are impacted.

The transition to alternative risk-free rates will affect individuals, companies and institutions who utilise a variety of financial services or products which rely on IBORs as a reference rate. Examples include floating rate bonds, adjustable rate mortgages, credit cards, as well as many types of loans and derivatives.

Transition could also affect funds and/or products in instances where such a financial product references an affected benchmark. Any changes to the benchmark, including its discontinuation, may, in turn, affect the economics and performance of the product.

Investments and products may also have an indirect exposure to an IBOR via risk management / valuation processes, or where the base rate for the interest charged for collateral, margining, or financing positions is an IBOR. However, this should not have a material impact, as the transition to new rates should occur before cessation of publication.

**5. What are the key market challenges for IBOR transition?**

IBOR transition is a complex undertaking. Its success is dependent on active collaboration between a range of different market participants and official sector bodies. Regulators have made it clear that they want transition to be a market-driven outcome, but as a result, divergent market approaches could emerge. Alignment and coordination between industry participants, legal advisers and accountants is needed. Without such coordination, the risks of transition may increase.

Building liquidity is vital, notably in derivatives which rely on the new rates - and market infrastructure, including trading, clearing and settlement mechanisms, needs to be adapted to handle instruments which reference the new rates.

**6. What are the key risks?**

IBOR benchmarks are used by several funds and fund managers as a reference rate for portfolio construction, agreeing terms with investors, for performance comparison purposes or potentially to calculate performance fees. For asset managers, the reform of major interest rate benchmarks (i.e. IBORs) will have widespread business implications.

The transition to RFRs may adversely affect the performance of a fund, mandates or products, its net asset value, earnings and potential returns to investors. Whilst many of these risks can be mitigated or minimised through the fund manager's own transition programme, it is not possible to avoid them altogether.

Operation of a fund, mandate or product, may include execution of transactions in instruments that are valued using LIBOR or other, currency specific, IBOR rates. Additionally, contracts may be entered into which determine payment obligations by reference to IBORs.

If an IBOR is discontinued or otherwise unavailable, the rate of interest on instruments referencing the IBOR will have to be determined based on any applicable fallback provisions. These fallbacks may in certain circumstances be reliant upon the provision by reference banks of offered quotations for the IBOR rate (which may also no longer be available), or may be drafted in a way that inadvertently converts a floating-rate instrument into a fixed-rate instrument (e.g. where the fallback only contemplates a temporary interruption in the availability of LIBOR and requires the use of the last published LIBOR rate instead). Amending such fallbacks to make them work in a post-IBOR world requires the cooperation of third parties, with some bonds e.g. requiring the unanimous consent of all bondholders in order to amend the interest calculation methodology.

Positions in IBOR instruments may suffer from reduced liquidity and fall in value as a result of its planned discontinuation. Also, any substitute reference rate and any pricing adjustments imposed unilaterally, by a regulator or by counterparties, may not be suitable for a fund, resulting in costs incurred to close out positions and execute replacement trades.

**7. How is Fidelity International responding to the move away from the IBOR benchmarks?**

Ahead of the expected discontinuation of LIBOR publication in 2021, Fidelity International established a cross-departmental RFR Transition programme in early 2018. The objective of the programme is to achieve a comprehensive transition away from the firm's various exposures to LIBOR, including investments in LIBOR-linked instruments and the use of LIBOR in Fidelity International's own products (e.g. the use of LIBOR as part of a product benchmark). An orderly transition will minimise disruption to AUM and protect the interests of Fidelity and its customers.

As the use of IBORs is embedded across a broad range of Fidelity International's business activities, the RFR programme has set up workstreams to manage the potential impacts to the following areas: Portfolio Management, Trading, Investment Technology, Product, Distribution & Communications, Finance, HR, Treasury, Tax, Legal, Risk Management, and Compliance.

Migration to replacement instruments using the new rates is expected to be driven by market conditions while the industry continues to work on the issues around managing legacy instruments ahead of the expected discontinuation of LIBOR. Any proposed changes to Fidelity International products will be communicated and agreed well in advance of this deadline. Fidelity International is closely following the industry-led working groups that are working with the Bank of England and other relevant regulators to ensure our preparations are appropriately aligned with the developments emerging from them. As required, Fidelity International will be in touch with clients with further details as the transition process continues.

**8. What is Fidelity International doing to mitigate the impact of any change for clients?**

In preparation for the discontinuation of LIBOR, Fidelity International has developed a transition plan which addresses the fundamental impacts noted above: instruments, benchmarks and indirect dependencies.

Fidelity International is:

- evaluating existing IBOR-linked exposures to understand the potential risks to client portfolios;
- identifying applicable referenced benchmarks in Fidelity International -issued products/funds and potential replacement indices;
- reviewing fallback language of existing investments/contracts in order to identify the appropriate action (if necessary) to be taken.

Fidelity International has developed action plans to deliver phased replacement instrument capability which will enable transition of instruments within funds when opportunities arise. This will enable Fidelity International to proactively migrate legacy reference rates to risk-free rates. Fidelity International has also taken the opportunity to enhance processes and systems capabilities.

Whilst the industry continues to work on the issues around managing legacy instruments ahead of the expected discontinuation of LIBOR, migration to new instruments using the new rates is expected to be driven by market conditions. Resulting from early engagement with vendors, industry groups and regulators, Fidelity International's delivery of enhanced functionality has seen funds already investing in RFR-based instruments, such as:

- RFR-based interest rate swaps as an alternative to LIBOR;

- RFR-based floating rate cash instruments.

Investment-decision making continues to be done on an investment risk basis, taking into account items such as: relevant value, current liquidity, presence of fallback language etc. However, as a result of the previously mentioned functionality being delivered, Fidelity International can provide comfort that the new conventions and methodologies FIL can provide comfort that, the new conventions and methodologies will not be determining factors in the management of your investments.

With regards to reference benchmarks in funds/products, any proposed changes will be communicated and agreed well in advance. Where relevant, Fidelity International will be in touch with you with further details as the transition process continues as required.

**9. Do I need to take any action?**

Fidelity International is managing the transition away from LIBOR and other IBORs in a way that is intended to minimise the effect on all our customers. We are working to ensure the transition is smooth, transparent and timely while always acting in the best interests of clients.

Any proposed changes to Fidelity International products will be communicated and agreed over the coming months. Further details will be shared as the transition process continues, including details relating to our approach on the use of the alternative interest rate benchmarks, information about when we will cease to offer legacy benchmark-based products and how we plan to deal with existing legacy benchmark-based transactions or products.

If you require any further information or have any questions or concerns relating to IBOR transition, we would encourage you to contact your usual Fidelity International contact or financial adviser.

**10. Where can I get further information?**

More information on SONIA and LIBOR transition in the UK is available from the RFR Working Group:

More information on EURIBOR reform is available from EMMI

More information on benchmark reform

https://www.ecb.europa.eu/explainers/tell-me-more/html/benchmark_rates_qa.en.html

https://www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-libor

SOFR: Alternate Reference Rate Committee (ARRC) website

€STER: Euro Working Group website

Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks