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LIBOR Retirement: Frequently Asked Questions (FAQ)

Due to questions raised around the reliability and validity of the London Interbank Offered Rate (LIBOR), the UK's Financial Conduct Authority (FCA) and Federal Reserve Bank of New York, along with other regulators and central banking authorities have initiated the retirement of LIBOR. This FAQ addresses the retirement milestones, replacements, operational and governance procedures, and other ongoing considerations in the transition.

Q1. What is LIBOR?

LIBOR is one of the most widely cited global reference rates in the world used to price financial instruments such as interest-rate swaps and securitized assets. Currently, LIBOR reflects the average interbank short-term borrowing rates of 16 major banks and is reported in five currencies—US dollar (USD), Euro (EUR), British pound (GBP), Japanese yen (JPY) and Swiss franc (CHF)—and for seven maturities, or tenors—overnight, one-week, and one-, two-, three-, six-, and 12-month—for a total of 35 different LIBOR rates. Since 2014, LIBOR has been administered by the ICE Benchmark Administration (IBA), which is regulated by the FCA and authorized under Regulation (EU) 2016/1011 of the European Parliament and the Council of 8 June 2016.

Q2. When will LIBOR be retired?

Both the FCA and the Federal Reserve Bank of New York have advocated for replacing LIBOR with benchmarks that are comprised of observable underlying transactions. Previously, the FCA had advised that panel banks would no longer be required to submit LIBOR rates beginning January 1, 2022. However, on March 5, 2021, the IBA stated it intends to cease publication of all 35 LIBOR settings on the below dates:

- December 31, 2021 – all GBP, EUR, CHF, and JPY LIBOR settings, and the one-week and two-month USD LIBOR settings
- June 30, 2023 – the Overnight and one-, three-, six-, and 12-month USD LIBOR settings

Q3. What impact does IBA's recent announcement to cease publication of all 35 LIBOR settings have?

The Alternative Reference Rates Committee (ARRC)[1] confirmed these announcements constitute a "Benchmark Transition Event" with respect to all USD LIBOR settings under ARRC-recommended

1 The ARRC is a group of private-market participants convened by the Federal Reserve Board and Federal Reserve Bank of New York to identify risk-free alternative reference rates for USD LIBOR, identify best practices for contract robustness and create an implementation plan with metrics of success and a timeline to support orderly adoption.

fallback language.[2] The occurrence of such an event does not require an immediate transition; actual transition under ARRC-recommended fallback language is based upon the “Benchmark Replacement Date,” which is expected to be on or after the cessation date.

In addition, the International Swaps and Derivatives Association (ISDA) published a statement that the announcement constituted an index cessation event under the IBOR Fallbacks Protocol and Supplement for all 35 LIBOR settings (more detail on the ISDA protocol can be found in question 14). As such, the Bloomberg-published fallback spread adjustment is fixed as of the date of the announcement for all euro, sterling, Swiss franc, US dollar, and Yen LIBOR settings. For cash products apart from loans to consumer borrowers, the ARRC recommended a spread adjustment will match the value of ISDA’s spread adjustments to USD LIBOR (spread adjustment details can be found in question 6).

Finally, the announcement constituted a cessation trigger in the EU for the European Commission (EC) to begin the process of designating the statutory fallback rates for LIBOR under the mechanism in the amended EU Benchmarks Regulation. Therefore, the EC is likely to issue a public consultation to determine the statutory fallback rates for the relevant LIBOR currencies.

Q4. What will be the alternative reference rate(s) to replace LIBOR?

Both the ARRC and the ISDA have identified SOFR as the replacement rate for USD LIBOR, the most heavily issued LIBOR rate. SOFR is an overnight risk-free rate based on overnight loans, secured by US Treasuries, and published by the Federal Reserve Bank of New York. ISDA has also specified the following alternative rates for each of the five LIBOR currencies as follows: SONIA for GBP LIBOR, €STR for EUR LIBOR, TONA for JPY LIBOR, and SARON for CHF LIBOR.

Q5. Has it been fully determined that SOFR is the replacement for USD LIBOR, and how is the SOFR market developing?

SOFR is the leading contender as a replacement rate for USD LIBOR. As a fully transaction-based benchmark, SOFR encompasses a robust underlying market. It is closely correlated to other money-market rates and covers multiple segments of the repurchase agreement (repo) market.[3]

Though alternative rate issuance such as SOFR has gained momentum, we continue to see significant issuance of LIBOR-linked instruments in the cash market and alternative rate issuance is heavily concentrated in agency products. In the derivatives market, counterparties are still incorporating LIBOR into the economics of a swap.

There are also other reference rates under consideration for USD LIBOR such as AMERIBOR (American Interbank Offered Rate) and the Bank Yield Index. The AMERIBOR, published by the American Financial Exchange, is based on actual unsecured borrowing costs of banks and financial institutions, and the Bank Yield Index was proposed by ICE Benchmark Administration in January 2019 to measure unsecured credit yields of global banks in various tenors.

2 ARRC-recommended fallback language refers to more robust fallback language for new issuance or originations of LIBOR floating rate notes, securitizations, syndicated loans and bilateral business loans to the extent it is not materially modified from the recommended language.
3 Repurchase agreements are short-term loans backed by collateral such as Treasury notes.

Q6. How will investors be compensated for the difference between IBOR and the eventual alternative rate?

A spread adjustment will compensate investors for the differences between LIBOR—a credit rate—and its risk-free replacement rates. Provisions continue to be ironed out.

For cash products, the ARRC plans to use the ISDA spread adjustment—specifically, the five-year historical median between SOFR and LIBOR for each tenor pair. However, the ARRC is still searching for an administrator to publish both the rates and spreads for commercial and consumer products by the end of March 2021. In the meantime, Bloomberg has begun to publish an indicative spread adjustment.

Q7. Will there be a forward-looking term SOFR?

The industry has identified a need for a forward-looking term SOFR—such as one-month and three-month rates, at a minimum. Term SOFR would function operationally more like today's LIBOR rates and allow Investment teams to forecast payments ahead of the interest period.

Q8. Will there be a legislative solution?

In March 2020, the ARRC proposed legislation to protect parties who adopt SOFR as a replacement for LIBOR under contracts governed by New York State law. This legislation was introduced in 2020 to the New York State Senate and the New York Assembly.

In October 2020, a draft bill was circulated to the US Congress that mirrors the ARRC's New York State proposed legislation. The bill would provide a safe harbor from litigation, establish the ARRC-recommended benchmark replacement as a viable commercial substitute for LIBOR and prohibit a party from refusing to perform its contractual obligations.

AB is in favor of implementing a legislative solution for USD LIBOR cash products, particularly at a federal level. Such legislation would provide consistency and standardization to financial markets. Legislation at the state or federal level would also reduce the risk of litigation and of any spread mismatch between LIBOR and the ARRC-recommended replacement rate.

Q9. How is AB handling governance and advocacy with respect to the transition?

To coordinate and mitigate risks around the firm's LIBOR transition, we have created an internal LIBOR Steering Committee, comprised of senior professionals across Portfolio Management, Trading, Operations & Technology, Risk Management, Legal & Compliance, Fund Accounting, and Finance. In biweekly meetings, the Steering Committee provides and receives updates on each of the core workstreams, including performance benchmark conversion, cash securities fallback language risk classification, derivatives transition and technology/system updates. We continue to monitor progress of implementation and adjust the plan and timelines as the transition evolves.

In addition, AB continues to advise on and provide input into various industry and regulatory efforts in response to the LIBOR transition. We have representation on the ARRC Legal Committee through our affiliation with Equitable Life, which is investigating legal and regulatory solutions. We are also active members of SIFMA Asset Management Group, where we provide feedback to ISDA on both the mechanics and content of the ISDA protocol for uncleared swaps, and we are engaged with the clearing houses on the transition for cleared swaps.

Q10. How is AB handling cash securities referencing LIBOR?

With respect to cash securities, we have onboarded a third-party vendor to help classify, according to risk level, the fallback language across our holdings The Investment teams are assessing and prioritizing the exit or transition of positions with inadequate or problematic fallback language—for example, language that indicates the deal will convert to a fixed rate at the last LIBOR setting. The high-risk category is also comprised of certain longer-dated deals and deals with no maturity.

Q11. For existing securities that reference LIBOR, what is fallback language? What is a trigger?

Fallback language refers to contractual provisions that outline the process for identifying a replacement rate in the event that a benchmark such as LIBOR is unavailable or deemed unrepresentative.

A trigger is an event that gives rise to a transition away from LIBOR. There are two types of triggers. A cessation trigger is a public statement indicating a permanent discontinuation of LIBOR, while a pre-cessation trigger is a declaration of LIBOR as no longer being representative (for example, because of an insufficient number of dealer quotes). The ARRC and ISDA have published a series of documents addressing fallbacks, such as the ISDA 2020 IBOR Fallbacks Protocol.

Q12. How is AB handling benchmarks referencing LIBOR?

We have identified all AB portfolios with LIBOR-linked benchmarks and have solicited feedback from the Investment teams regarding appropriate alternatives. For segregated account mandates, we expect most of these benchmark changes to take effect in mid-2021, in consultation with clients.

For AB-sponsored funds, we expect to transition the LIBOR-linked performance benchmarks to SOFR-linked or relevant currency benchmarks in mid-2021. Notably, a LIBOR benchmark is used for performance comparison only. Therefore, transitioning to alternative benchmarks will not affect the way that these funds are managed.

The following AB-sponsored funds have LIBOR-linked performance benchmarks that will be transitioning:

Umbrella	Portfolio
AB SICAV I	ALL MARKET INCOME PORTFOLIO
AB SICAV I	ALL MARKET TOTAL RETURN PORTFOLIO
AB SICAV I	ALTERNATIVE RISK PREMIA PORTFOLIO
AB SICAV I	EMERGING MARKET DEBT TOTAL RETURN PORTFOLIO
AB SICAV I	EVENT DRIVEN PORTFOLIO
AB SICAV I	FINANCIAL CREDIT PORTFOLIO
AB SICAV I	GLOBAL DYNAMIC BOND PORTFOLIO
AB SICAV I	LOW VOLATILITY ALL MARKET INCOME PORTFOLIO
AB SICAV I	SUSTAINABLE ALL MARKET PORTFOLIO
AB FCP I	DYNAMIC DIVERSIFIED PORTFOLIO
AB FCP I	MORTGAGE INCOME PORTFOLIO
ALLIANCEBERNSTEIN FUND	FIXED MATURITY BOND 2023 PORTFOLIO
ALLIANCEBERNSTEIN FUND	DYNAMIC ALL MARKET PORTFOLIO
ALLIANCEBERNSTEIN FUND III	MERGER ARBITRAGE

Q13. What will the impact be on cleared derivatives during the phaseout of LIBOR?

For derivatives, there were two major developments relating to the LIBOR transition that occurred during 2020, the first was the cleared derivative market's discounting and Price Alignment Interest (PAI) transition from Fed Funds to SOFR. The transition applied to the underlying benchmark utilized for discounting USD-cleared swap contracts as well as the overnight cost of funding collateral.

The discounting transition, also referred to as "the Big Bang," was facilitated by the central counterparty clearing houses (CCPs), including London Clearing House (LCH) and the Chicago Mercantile Exchange (CME), and took place after close of business on October 16, 2020, with all cleared swaps being discounted using SOFR the following business day.

To adjust for the change in valuation, market participants had the option to receive basis swaps or resulting cash from selling at auction. AB selected cash compensation at the recommendation of AB Trading. The same was accomplished in Europe in July 2020 with the transition of EUR-cleared swaps from the Euro Overnight Index Average (EONIA) to €STR for price-aligned interest and discounting with cash compensation for the difference.

With respect to valuation and pricing for cleared swaps linked to LIBOR, the CCPs intend to incorporate the ISDA Fallback Supplement into their rule books for new and legacy trades. LCH and CME have recently published consultations on the cessation of LIBOR, and AB is participating with trade associations to provide feedback.

Q14. What will the impact on uncleared derivatives be during the phase-out of LIBOR?

ISDA recently published the ISDA 2020 IBOR Fallbacks Protocol for uncleared swaps (refer to link above), which AB has adhered to[4]. The Protocol took effect January 25, 2021 from which point all legacy trades in which both parties have adhered to the Protocol include the updated fallbacks and triggers for covered IBORs. The ISDA IBOR Supplement also took effect on January 25, 2021 and includes the fallbacks and triggers for new transactions.

Q15. How does the LIBOR Retirement affect AB Operations and Technology?

Our Global Operations & Technology team has dedicated personnel to evaluate internal systems and infrastructure to ensure a smooth transition to an alternative rate environment. Our systems and infrastructure remain flexible with respect to order management, pricing and valuation.

We regularly review pricing, valuation, cash forecasting and risk-sensitivity calculations, and make appropriate changes as needed. For example, in preparing for the price-aligned interest and discounting transitions, we have sourced alternative rate curves and implemented methodology changes to shift from EONIA to €STR and from EFFR to SOFR.

While some uncertainties persist, the phasing out of LIBOR is now well under way. We are continually monitoring the markets and industry best practices as the transition to replacement rates unfold, and we remain focused on positioning our clients and our firm for a successful transition, well ahead of LIBOR's anticipated retirement.

4 Clients who execute their own agreements will need to adhere to the ISDA Protocol to ensure that all legacy transactions are amended.