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RFR transition beyond G5

Alternative reference rate adoption hastens

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Beeline to join the ARR bandwagon

Following the transition of Group of 5 (G5) currencies — the US dollar, pound, euro, Swiss franc and yen — to their respective alternative reference rates (ARRs) from interbank offer rates (IBOR), focus has shifted to the migration of Asia-Pacific (APAC) and Latin American (LATAM) currencies.

The G5 currencies have considerable global impact as these represent significant volume of transactions across major global banks. The transition to their respective risk-free rates (RFRs) has led to the setting up of systems and methodologies, and standardised processes.

Even though the lessons learnt from the transition of G5 currencies can be leveraged, the adoption of ARR by other economies will not be easy, owing to liquidity constraints, unorganised market structure and lack of clear regulatory mandates.

In this paper, we explore the intricacies and challenges in ARR adoption for a few key currencies.

JPY TIBOR cessation

The Tokyo Interbank Offered Rate (TIBOR), which is published by the Japanese Banking Association TIBOR Administration (JBATA), is an interest rate benchmark for the yen, mainly used in loans and derivative transactions, and comprises Japanese yen TIBOR and Euroyen TIBOR.

In May 2019, JBATA published its first consultation paper on retaining Japanese yen TIBOR and discontinuing Euroyen TIBOR. Following discussions, JBATA has decided to discontinue Euroyen TIBOR by end-December 2024, with the cessation date for booking new trades based on the benchmark set six months prior to the deadline, i.e., June 2024.

However, there needs to be further discussions to resolve the following key issues:

- Lack of clarity on the methodology to calculate fallback rates and issues with existing contracts caused by the replacement of the benchmark
- Limited window for banks to implement changes in their existing systems to ensure smooth transition
- Hedge accounting and interest rate swap clearing issues

KOFR adoption

South Korea is also working on adopting RFR, with the Korea Securities Depository tasked with executing the development and publication of the Korea Overnight Financing Repo Rate (KOFR). To be sure, the depository has officially published the KOFR since November 26, 2021. Unlike certificate of deposit (CD) rates, KOFR is directly computed by the Korea Securities Depository, based on real transaction data.

Though there is no set timeline for the transition, market participants expect this once the regulator opens the USD/Korean won (KRW) spot market to offshore investors. In fact, demand for the KOFR could gather momentum once the domestic regulator includes Korean government bonds in the World Government Bond Index and enables CD/KOFR transition.

RFR transition of MXN TIIE

Market participants are preparing for the transition of the Mexican Interbank Equilibrium Interest Rate (MXN TIIE) Index, which has a swap market size of $4.9 trillion in terms of central clearing counterparty volume. The TIIE will move to a new overnight funding rate called TIIE de Fondeo on January 1, 2025.

In fact, from January 1, 2024, TIIE rates with maturities longer than one business day started transitioning to the new overnight rate, i.e., 91- and 182-day tenure TIIEs. The 28-day TIIE will transition to the new overnight benchmark on January 1, 2025. However, the referencing of 28-day TIIE for new agreements will be prohibited from January 1, 2025.

It should be noted that the MXN RFR transition is relatively different from the transition of other currencies, as the 28-day TIIE will not cease to exist, only the method to compute it will change.

The major challenge for banks, though, is to transition their existing systems and infrastructure to the new TIIE de Fondoe Index rate and the fallback spread.

- The new overnight TIIE de Fondeo Index rate is calculated based on real transaction data where the benchmark is determined on wholesale repo transactions. Also, the index rate is a volume weighted median of interest rate paid on repo transactions
- The other challenge for banks is the divergence in the methodology for computing fallback spread based on Bank of Mexico (Banxico) and Chicago Mercantile Exchange (CME) clearing. The fallback spread for legacy trades is 24 basis points (bps) as per Banxico methodology and 23 bps as per the CME proposed International Swaps and Derivatives Association methodology

Another major challenge for market participants is transitioning all existing contracts to the new standards within stringent timelines.

Hence, market participants and the regulator need to collaborate closely to implement a common methodology for determining the fallback spread.

Though the market for TIIE de Fondoe is almost negligible, its liquidity is expected to quickly increase amid planned Central Counterparty (CPP) adoption in September 2024.

Note: As per our recent industry interactions, CME has confirmed that it will also comply with Banxico methodology, which London Clearing House (LCH)has already adopted.

SGD SORA adoption

The Association of Banks in Singapore and the Singapore Foreign Exchange Market Committee (ABS-SFEMC) recommended Singapore Overnight Rate Average (SORA) as the most suitable and robust benchmark to replace the SGD Swap Offer Rate (SOR) for interest rate derivatives. The Steering Committee for SOR Transition to SORA (SC-STS) was tasked to provide strategic direction and oversee the transition to SORA from SOR.

The Singapore Interbank Offered Rate will be discontinued after December 31, 2024. Hence, outstanding SOR-based business loans and derivatives that mature after that date will require a new fallback rate. Separately, the SC-STS will also provide supplementary guidance on adjustment spreads to apply for interest rate periods before end-2024 to support the industry’s ongoing transition of wholesale SOR contracts.

- **Methodology:** The SORA is a volume-weighted average rate of borrowing transactions in the unsecured overnight interbank SGD cash market in Singapore
- **Publication:** Along with SORA index, one-, three- and six-month compounded SORA and other relevant details are published daily on the Monetary Authority of Singapore’s (MAS) website and through third-party redistribution services
- **Contingency SORA:** If the data is not sufficient, the SORA will not be computed using the normal methodology and a contingency process will be triggered, i.e., contingency SORA
- **Fallback spread:** The MAS decided to keep the FX implied SOR fallback rate on all transactions until December 2024. Any fixings beginning January 2025 will start using the RFR rate plus the MAS adjusted spread. Adjustment spreads within the MAS Recommended Rate is derived from the historical median spread between the SOR and the SORA. Together with the linear interpolation outlined in the supplementary guidance,

the historical median approach will serve to reduce inequity or unintended value transfer among different participants to the same contract, which may arise from a conversion to SORA from SOR.

The tenure-specific cessation dates for fallback SOR are:

– Overnight: January 3, 2025
– 1-month: January 31, 2025
– 3-month: April 2, 2025
– 6-month: July 2, 2025

THB

The Bank of Thailand decided to cease the Thai Baht Interest Rate Fixing (THBFIX), which is linked to the USD London Interbank Offered Rate (USD LIBOR), from June 2023. However, the central bank introduced a fallback THBFIX rate, calculated using the USD SOFR index + spread. This rate will be published only until the end of 2025 and can be adopted only on legacy contracts.

The cessation dates for the term fallback rates are:

- 6 months: July 3, 2025
- 3 months: October 2, 2025
- 1 month: December 1, 2025
- THBFIX: December 30, 2025

Any contracts with maturity beyond 2025 need to switch to a new ARR, known as Thai Overnight Repurchase Rate (THOR), from the THBFIX fallback rate. It was first published in April 2020, together with the THOR average, which is the compounding-in-arrears rate for one, three and six months. The Bank of Thailand supports the adoption of THOR as an ARR for all new contracts to improve its liquidity. Also, banks need to ensure that all contracts based on THBFIX have fallback provisions.

ZAR

ZARONIA (South African Rand Overnight Index Average) has been designated as the preferred alternative near RFR to succeed JIBAR (Johannesburg Interbank Average Rate). The South African Reserve Bank (SARB) started publishing ZARONIA on its website in November 1, 2022, and after a year-long observation, on November 3, 2023, declared that ZARONIA can be used for financial contracts.

Although JIBAR will continue to be published for the foreseeable future, market participants are strongly encouraged to consider the implications of the JIBAR transition plan for their business operations and strategy, and plan to minimise the amount of JIBAR-related exposure.

The SARB will determine the appropriate time for ceasing the publication of JIBAR, which will be preceded by an announcement of the event and the JIBAR cessation date.

ILS

SHIR (Shekel Overnight Interest Rate) is intended to replace TELBOR as an RFR as per the TELBOR committee. On April 16, 2024, the TELBOR committee declared that all tenures of TELBOR will cease to be published following the publication of SHIR from June 30, 2025. From that point, fallbacks (to the adjusted RFR *plus* spread) will automatically apply for outstanding TELBOR derivatives contracts.

CZK

In October 2023, the Czech Financial Benchmark Facility (CFBF) published a notification of changes to the PRIBOR (Prague Interbank Offered Rate) benchmark, specifically changes to the published tenures. The CFBF will cease provision of two- and nine-month tenures of the PRIBOR benchmark from April 1, 2025.

Our expertise and experience in RFR migration

The transition to ARR from IBOR is a dynamic process. Hence, market participants need to continuously monitor regulatory developments and be prepared to adapt to the changes. They must also adopt industry best practices, track regulatory updates and monitor market dynamics to make informed decisions throughout the transition process.

Indeed, ARR adoption marks a significant shift in the financial landscape. Market participants, regulatory bodies, and industry stakeholders need to collaborate closely to successfully navigate this transition.

By focusing on global standardisation, addressing challenges in implementation, effectively managing risks, upgrading technology and infrastructure, and fostering open communication with clients and regulators, the financial industry could effectively resolve challenges associated with ARR adoption.

CRISIL has in-depth know-how of the various regulatory landscapes and experience in implementing RFR transition, thereby supporting financial institutions in their efforts to shift to ARR from IBOR.

CRISIL is currently supporting clients on the following RFR activities:

- Construction and testing of the RFR curve
- Building of technology and pricing library for RFR adoption
- Thorough quantitative testing of various milestones of RFR adoption for the trading desk and other functions, such as finance and market risks
- Assist with gap analysis and contract remediation

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