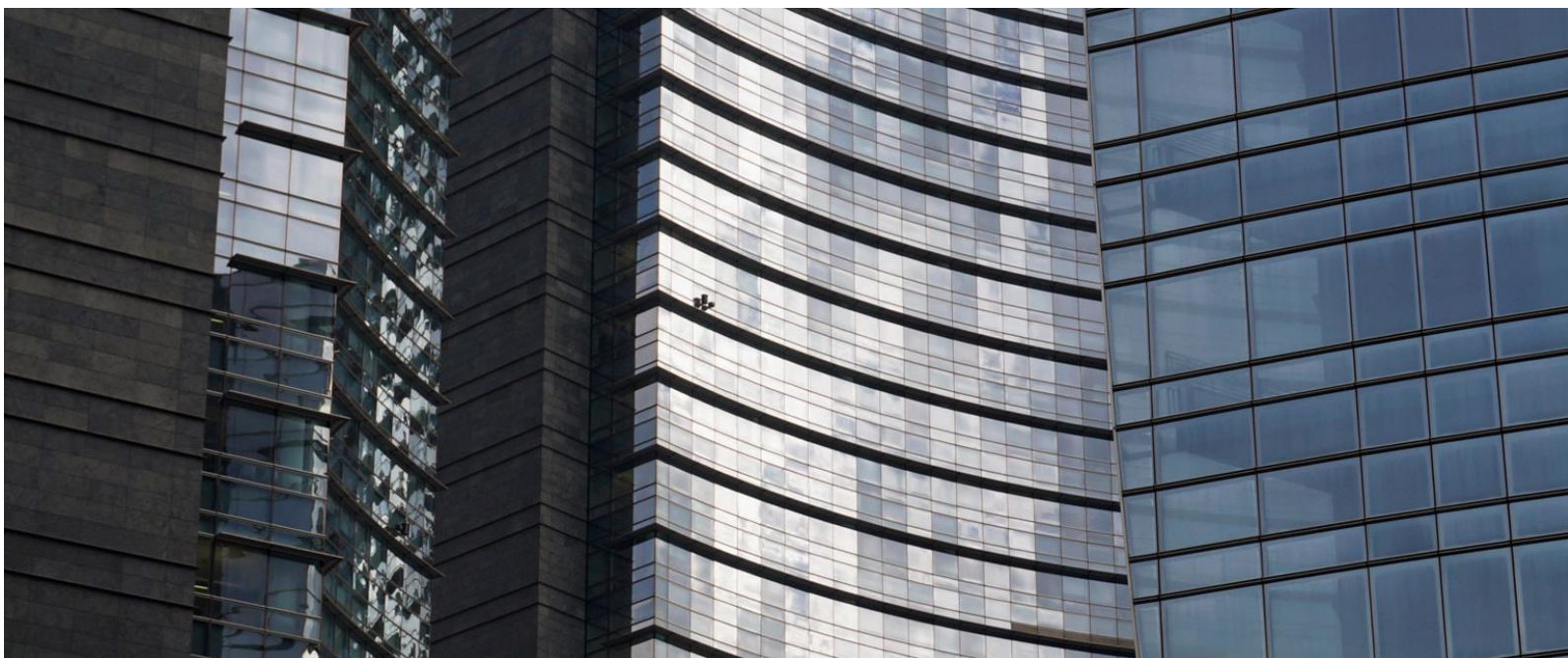


IBOR Transition

A Nordic Perspective



Firms are generally well progressed when it comes to LIBOR; however, for local currencies, questions remain on what will happen to the existing IBOR; how this will relate to the new RFR; and, in turn, what this will mean for related products. Now is the time to act. The transition will not disappear; its only foreseen to become more disorderly and will impact other initiatives, if not dealt with properly.

Background

In 2013, the G20 asked the Financial Stability Board (FSB) to undertake a fundamental review of major interest rate benchmarks. This work led to the recognition that, even after reforms that strengthened the underlying processes, certain risks relating to robustness and reliability of IBORs could not be fully addressed.

In 2017, the Financial Conduct Authority (FCA), the UK body that regulates LIBOR, declared that after 31 December 2021 it will no longer compel banks to continue making LIBOR submissions. As a result, the number of submissions could fall significantly, reducing the representativeness of LIBOR or causing LIBOR publication to cease

entirely. The FCA's statement triggered what is now known as the IBOR Transition.

LIBOR (GBP, USD, JPY, CHF and EUR) and other IBORs (NIBOR, STIBOR, CIBOR etc.) are deeply entrenched in financial firms' contracts, processes and data. The rate is so embedded in day-to-day financial service activities that even identifying a firm's exposures to it—which is just one element of what is needed to transition successfully—is a highly complex task.

Firms need to move away from IBORs to using the more robust and transaction-based risk-free rates ("RFRs"). Deadlines for activities differ by currency; however, for LIBOR, countries are pushing to end the reliance on LIBOR for new activity at least by the end of 2021.

LIBOR transition is most pressing for banks with LIBOR exposure due to the imminent deadlines; however, IBOR Transition covers more than just LIBOR. For example, the [BMR](#) requires all contracts using reference rates to include fallback language to cover the event of an IBOR cessation, which also implies that banks must be operationally ready to use RFRs in their systems and processes, even if the IBOR will continue into 2022 and beyond. The risks of a poorly managed transition are business critical, with possible consequences including:

- Inability to serve clients in the market;
- Drop in revenues;
- Compliance and reputation risk;
- Inadequate risk management and accounting; and
- Unforeseen operational and system impacts.

Although regulatory deadlines have been [shifting](#), the change to these fundamental numbers should not be underestimated. There are interim milestones to reach over the coming years that require attention from across the business, for example, how will firms handle and

integrate the new overnight rates into operations and products.

Following on from our [2021 regulatory outlook](#), this blog will dive into the IBOR transition from a Nordic perspective to outline areas of focus, guide you through the status of the Nordic currencies and highlight how the transition impacts Nordic banks.




Country	IBOR	RFR	Administrator	RFR Live Date	Status
	NIBOR	Norwegian Overnight Weighted Average (NOWA)	NIBOR – The Norske Finansielle Referanser AS (NoRe) NOWA – Norges Bank	Reformed NOWA from 1 January 2020.	The RFR in Norway (NOWA) will be the O/N borrowing rate. Currently, there is no cessation date for NIBOR, with a dual rate structure likely for the medium term.
	STIBOR	SWESTR (Swedish Krona Short-Term Rate)	STIBOR – Swedish Financial Benchmark Facility SWESTR – Sveriges Riksbank	SWESTR test period commenced 27 January 2021	STIBOR is a critical benchmark, and SFBF have until 31 December 2021 to submit their application for authorisation. SFBF currently have a STIBOR reform process underway, and a public consultation is due in early 2021.
	CIBOR	Danish ESTR (DESTR)	CIBOR - Danish Financial Benchmark Facility (DFBF) DESTR - Danish Central Bank	January 2022	The RFR in Denmark (DESTR) will be the O/N borrowing rate. It is expected that CIBOR will continue with the current methodology for the foreseeable future with no known cessation date.
	EONIA EURIBOR	Euro short-term rate (€STR) Hybrid EURIBOR	EONIA and EURIBOR – European Money Markets Institute (EMMI) €STR – ECB	1 October 2019	€STR will replace EONIA and is the new Euro Short-Term Rate. The cessation date for EONIA is scheduled for 3 January 2022. EURIBOR will continue with a new hybrid methodology.
	REIBOR	Not decided yet	REIBOR – Central Bank of Iceland	N/A	The Central Bank of Iceland is working in collaboration with commercial and savings banks on finding a new base for interest rates. The REIBOR rate will be calculated and utilised until further notice.

Figure 1 – Overview of Nordic RFRs

Where are we in the Nordics?

Each Nordic country is at a different stage when it comes to developing RFRs. Figure 1 provides an overview.

Norway

The current reference rate is NIBOR. This is not expected to cease in the short term, however, the future of NIBOR is uncertain. Similarly to other IBORs.

The Norwegian ARR working group published its [recommendation of a reformed version of NOWA](#) as the RFR for Norway in September 2019. This began to be published on 1 January 2020.

The working group has published reports on [market standards and fallback solutions for the reformed NOWA](#) and [establishing an OIS market in NOK](#). The report noted that “the ARR group has no indication that NIBOR will cease, so it is likely that NOWA and NIBOR will be used in parallel as reference rates in the market”.

Until an OIS market for NOK is developed, market participants must plan for a transition from NIBOR to the reformed NOWA from the date NIBOR is no longer published. Such a transition may at first glance seem trivial, but there are material differences between the reformed NOWA and NIBOR that institutions must take into consideration:

- NIBOR is a tenor rate, whereas NOWA is a 1-day overnight rate. This means that there will be different credit and liquidity premiums between the rates, for example.
- NOWA will have to be compounded, impacting the liquidity management, among other things. The devil is in the detail, and firms must pay close attention to get a comprehensive overview of financial, capital, liquidity and operational impact.

Sweden

The current reference rate is STIBOR; one of only a small number of rates classified as ‘critical’ under the EU Benchmark Regulation, which imposes additional requirements on the benchmark over and above those for significant benchmarks. This classification has also meant that STIBOR is covered by the extension of the transitional provisions to December 2021, which allowed the financial institutions to continue to use benchmarks where the administrator had not yet been authorised, as per the EU BMR.

During 2020, the administration of STIBOR was transferred from Financial Benchmarks Sweden, a subsidiary of the Swedish Bankers’ Association, to the Swedish Financial Benchmark Facility (SFBF). As of now, SFBF is not yet authorised as a benchmark administrator under BMR; however, work is progressing on the STIBOR reform, and the SFBF intends to submit a formal application for authorisation in 2021. The reform is expected to include clarification of the current definition of STIBOR and a potential reform of the methodology; it is the aim of the SFBF to manage this transition without significant impact on the value or volatility of STIBOR.

Whilst STIBOR reform is a key aspect of the IBOR transition in Sweden, work has also been progressing to develop a transaction-based overnight rate. During 2019, a working group under the Swedish Bankers’ Association made a series of [recommendations on the potential structure and calculation of an overnight rate](#). In late 2019, it was confirmed that the Riksbank would be the provider of this rate (i.e. calculator, publisher and administrator). However, the timeline for the test period and final publication of this rate was affected by the global Coronavirus pandemic and was delayed. In October 2020, the Riksbank published [their consultation on the final proposals for the calculation methodology and publication process](#). A test period for SWESTR (Swedish Krona Short-Term Rate) went live on 27 January 2021 and will operate for approximately six

months. During this period, the rate will be published daily but is not to be used in financial products.

Denmark

The current reference rate is CIBOR, and there is no formal obligation to replace CIBOR, since it is not considered a 'critical' benchmark rate. Reference rates are used in a wide range of financial contracts, including loans, mortgage bonds and interest rate swaps. Thus, it is important for Denmark's central bank, Nationalbanken, and the financial system that a short-term transaction-based reference rate is introduced in Danish kroner, in line with international standards.

Denmark's central bank will be the administrator of the new Danish reference rate, DESTR (Danish ESTR), scheduled to be launched in early 2022 following a test period in 2021. DESTR is based on overnight borrowing transactions, which Denmark's central bank will collect from a broad group of banks as part of a new statistic for 1-day money market rates. The new statistic is set to be extended to a broader range of money market rates and foreign exchange transactions in the coming years.

Furthermore, Denmark's central bank will establish a working group with participation from the banking sector that will prepare a proposal for the transition from and discontinuation of the existing short-term reference rate.

Finland

There are two main reference rates used in the euro area and in Finland under the IBOR reform: EONIA and Euribor.

Starting on 1 October 2019, EONIA (Euro Over-Night Index Average) is calculated as €STR + 8.5bps, where €STR is the new Euro RFR reflecting the overnight borrowing costs of banks in the eurozone. €STR will replace EONIA, which is scheduled to be discontinued on 3 January 2022.

For EURIBOR, a hybrid methodology is applied, where realised money market transactions are considered for maturities ranging from 1 week to 12 months.

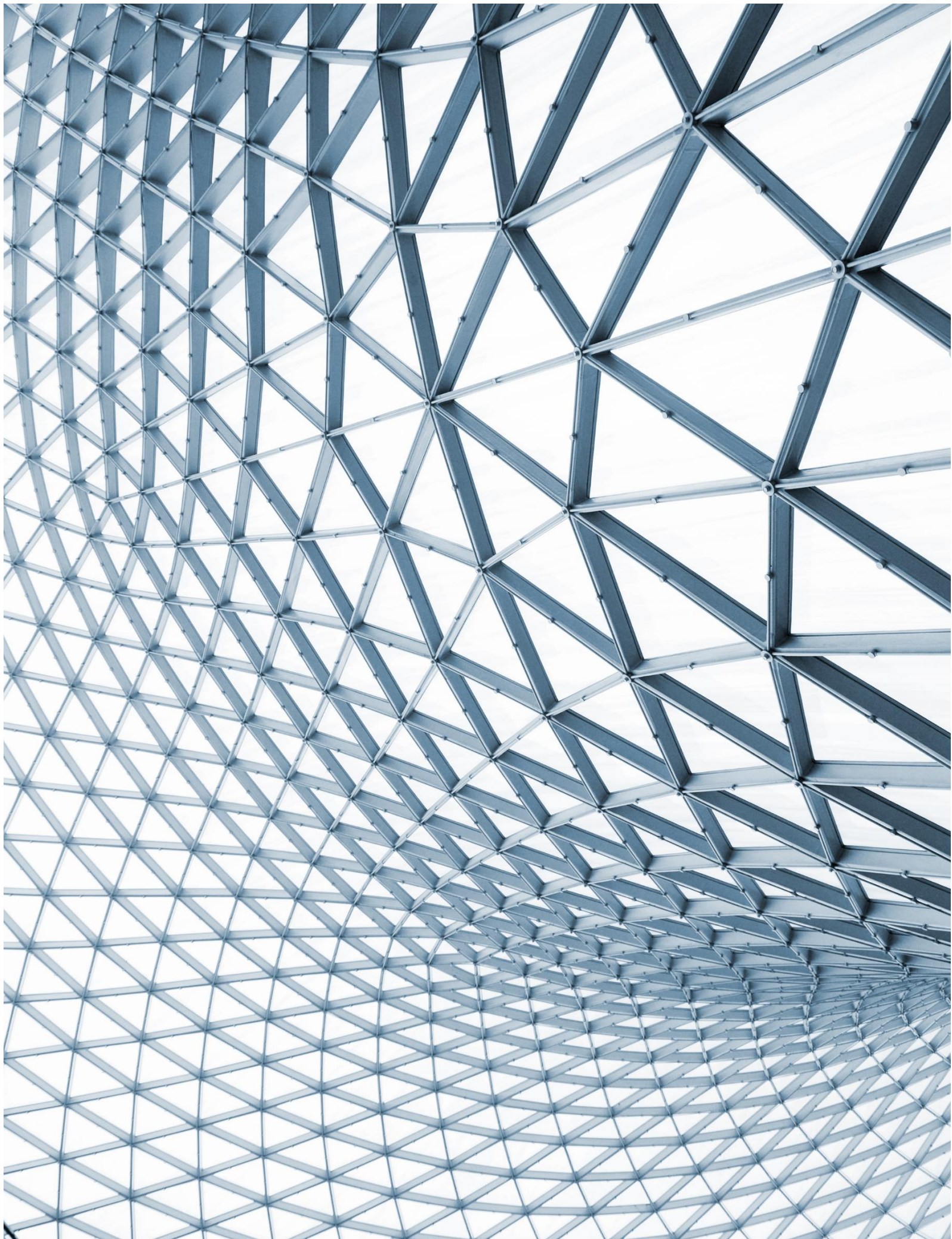
[The Finnish FSA conducted a questionnaire in June 2019](#) and made the following remarks:

- Some institutions using EONIA had not considered that the new calculation method for EONIA could impact their balance sheet;
- It must be emphasised that the cessation of EONIA after January 2022 leaves €STR as the only overnight rate in the eurozone;
- Operational aspects resulting from the IBOR reform, such as changes when daily quotes are being published, were not considered in all answers;
- Transparency towards customers regarding effects to their contracts was vague; and
- Continuity plans among banks were different in contents, as banks had not captured all the EU Benchmark Regulation requirements. Three respondents could not deliver the requested continuity plan.

In summary, the responses received imply clear differences across banks in the level of preparedness for the IBOR transition. In addition, there are notable areas for improvement in customer communications.

Iceland

REIBOR is the formal interbank market rate. The Central Bank of Iceland is working in collaboration with commercial and savings banks on finding a new base for interest rates. The REIBOR rate will be calculated and utilised until further notice.



Key questions for your firm to consider

As you can see, each Nordic country is at a different stage regarding IBOR transition and the developments of RFRs and the associated markets. Developments in Nordic reference rates are running concurrently with the changes to EUR, USD, GBP, which for many institutions creates a more complex program of activity with many moving parts.

Although banks look more set than other sectors to complete the transition, the wider market - corporates, insurers and some investment managers – remains less engaged by comparison. For many Nordic organisations predominantly doing business in local currencies, awareness is generally lower, and businesses are preoccupied with handling their pandemic responses. Banks, in general, could be faced with a tough challenge in creating client attention, especially when it comes to updating or migrating legacy contracts.

For that reason, certain LIBOR rates are set to survive beyond 2021 (initially to mid-2023 for USD) to allow the tail of ‘tough’ contracts to mature, although some tenors and currencies (e.g. EUR and CHF) will drop out. There remains a risk of a disorderly transition, and banks should at least be prepared to run parallel processes for ‘old’ and ‘new’ contracts. This involves a considerable risk of creating confusion, as well as a basic risk and lack of liquidity in certain products.

With these ‘known unknowns’, Nordic banks should have started an IBOR transition project with clear mitigation activities. For example, firms should have a clear view of their IBOR impacts and financial exposures and have analysed their product portfolios to develop a new product strategy. Based on this, firms can prioritise the transition and monitor where they have the largest risk and systematically be de-risking their portfolios rather than digging the hole ever deeper.

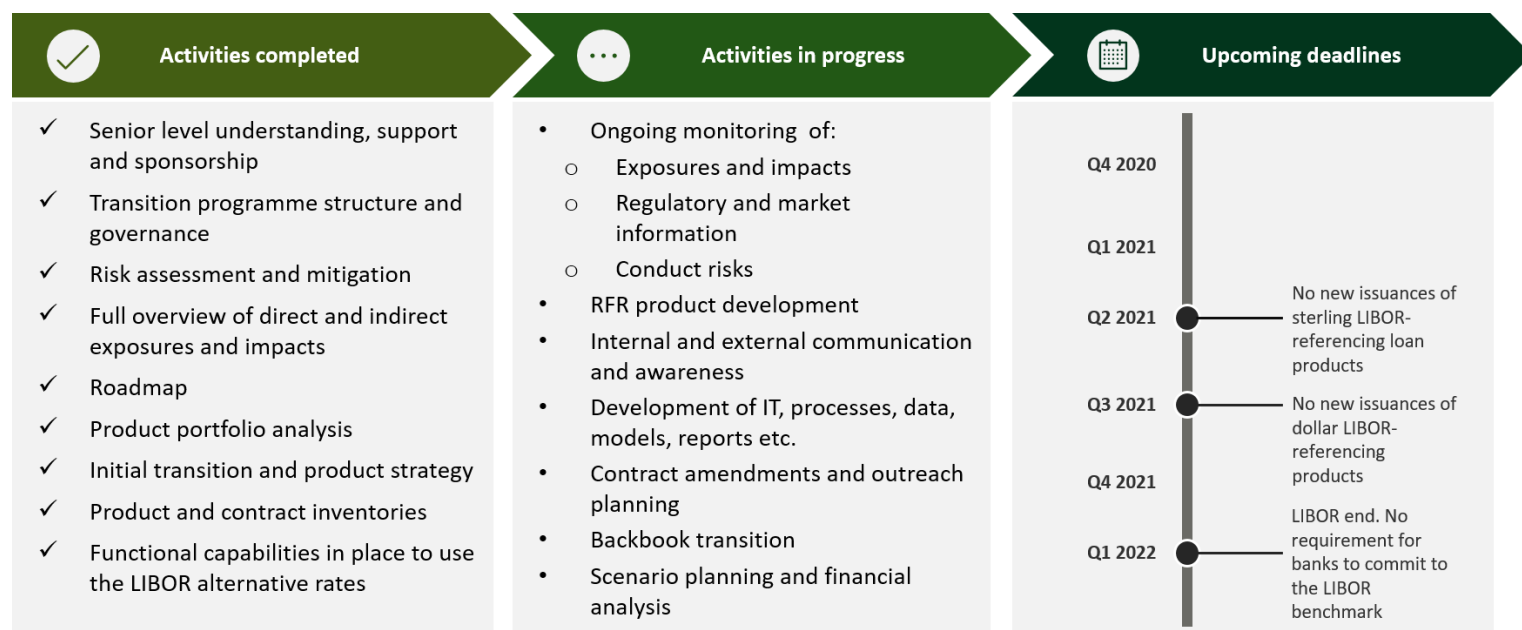


Figure 2 – Expected high-level project progress

Questions to check your progress against our expectations:

- Do you have a full overview of IBOR exposures and impacts?
- Are you on track to meet the LIBOR deadline at year-end 2021?
- Have you started developing RFR-based products?
- Are new product strategies in place and aligned with client needs?
- Do you have a plan for contract amendments and outreach?
- Are you preparing internal systems and processes for a dual rate structure to run products that could use different reference rates (e.g. IBOR or RFR)?

To plan for local rate changes amid uncertainty, consider the following questions:

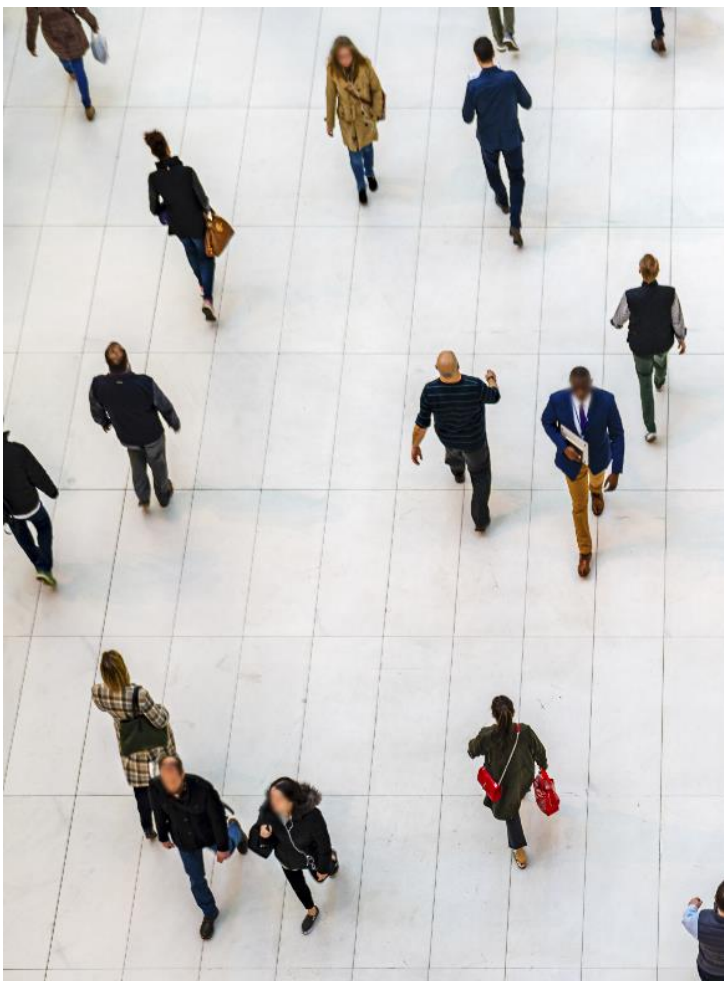
- How quickly will the new overnight rate become established in domestic markets?
- How will it be used in domestic and cross-currency financial products?
- What approach will the market adopt in relation to fallback provisions for related contracts, and when will they need to be in force?

Conclusion

If banks do not make adequate progress with their preparations for the IBOR transition, supervisory tools may be deployed to accelerate the transition.

Firms are generally well progressed when it comes to LIBOR; however, for local currencies, questions remain on what will happen to the existing IBOR; how this will relate to the new RFR; and, in turn, what this would mean for related products. Firms must monitor working group updates, while making some assumptions to prepare for different scenarios. The following examples outline different scenarios that you could face during the transition:

- How would multi-currency swaps work if using an IBOR on one side and an RFR on the other?
- Multi-currency loan facility, cross currency, derivatives, swaps and other exotics will create issues during transition due to tough legacy contracts and timing issues.
- Be prepared for complex valuation, pricing and risk methods to deal with the dual-rate structure.
- Clients may need to be contacted to manage changes to legacy positions across different currencies where transition is running to different timelines.



We have seen that it is common for firms to underestimate the exposure and amount of work necessary for transition – this is not just “another reference rate change”. The key differences between IBORs and RFRs add complexity to the transition that affects many departments including products, risk, finance, data and legal.

Now is the time to act. The transition will not disappear; its only foreseen to become more disorderly and will impact other initiatives, if not dealt with properly.

Through our work with Nordic clients, Deloitte has built up practical, hands-on experience which we aim to use to help strengthen the Nordic financial sector during this unprecedented change.

Contact our experts to learn more about the transition and how firms can prepare.

Other information that may be of interest:

- The Deloitte [IBOR reform](#) website
- Article: [ISDA's IBOR Fallbacks Supplement and Protocol](#)
- Article: [2020 – A Critical Year for LIBOR Transition Activities](#)
- Article: [2020 – A Critical Year for LIBOR Transition Activities](#)
- Article: [LIBOR – 2020 make-or-break](#)

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