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The end of LIBOR

Identifying implications and taking measures at an early stage

Finance- and Treasury Management Switzerland

Years of rigging and illegal agreements between the banks involved have discredited the reference interest rates LIBOR and EURIBOR. As a consequence, the UK financial regulator wants to put a stop to interest rates being determined by daily queries on interbank interest rates, effective from 2021 onwards.

Instead, they are to be calculated on the basis of real transactions by the central banks of the respective currency areas. In addition, the investigation procedures for EURIBOR and EONIA must be revised in application of EU Regulation 2016/1011 by 2020. This means that not only the financial world, but also corporations are facing a development that should not be underestimated.

Thanks to the clear positioning of the British financial supervisory authority, the reform, which has been underway since 2014, will be completed in 2021. Both LIBOR and EURIBOR are to be replaced by alternative, risk-free reference interest rates; their implementation and data basis are currently being discussed in currency-specific working groups (see Table). However, the resulting conversion effects will already impact Corporate Treasury before that and therefore require early action.

Currency	Risk-free interest rate	Working group	Data base
Sterling (GBP)	SONIA	Bank of England Working Group	Unsecured, bilaterally traded overnight rate
EURO (EUR)	ESTER	Working Group on Euro Risk-Free Rates	Individually traded bank transactions, due daily
US-Dollar (USD)	SOFR	Alternative Reference Rates Committee	Secured, transaction-based overnight rate
Swiss Franc (CHF)	SARON	National Working Group on Swiss Franc Reference Rates	Repo transactions in CHF in the interbank market
Japanese Yen (JPY)	TONAR	Japan Study Group on Risk Free Rates	Unsecured, transaction-based overnight rate

The main distinction between current and future reference rates (RFRs) consists of the following three aspects:

1. In contrast to LIBOR, the respective currency-specific interest rates will be based on different data sources. This results in various publishing times (such as SONIA 9 AM GMT and SARON 8.30 AM MET).
2. The tenor is another important difference between the future reference rates. While current interest rates are published for various maturities, the new reference rates are currently

largely only available as overnight rates. Further tenors are under discussion in the respective working groups.

3. The new reference rates differ in the degree of collateralization. The uniform handling previously possible for LIBOR will therefore no longer be possible and will require a currency-specific consideration. These changes will have an impact on various corporate departments.

How will this impact companies?

LIBOR/EURIBOR are standard reference rates for the variable interest rate of both primary and derivative contracts, many of which mature beyond 2021. For contracts concluded before 2021, the change in the corresponding reference rate will most likely affect the market value of the underlying financial instrument. For free-standing derivatives, for example, this will lead to changes in value to be recognized in the income statement.

It may also affect derivatives used in hedge accounting, as an effect on the hedging relationships under IFRS 9 is to be expected - which may also have to be reflected in the income statement. Switching reference interest rates therefore will have direct and indirect effects on the balance sheet and significantly influence all of the valuations and the shape of the yield curves.

Depending on the tenors available in the future, the tenor-specific yield curves in particular must be remodeled or fundamentally adjusted. It should also be remembered that CCBS (cross currency basis swaps) quotes are currently based on LIBOR rates and will therefore pose a future challenge in determining yield curves for the different currencies.

An adjustment as a result of the necessary conversion is also conceivable for primary financial instruments, which could result in a change in the planned cash flow structure and a possible early realization of the transaction costs. The changeover of the reference interest rates also requires an adjustment of the underlying contracts, which will cause both internal and external transaction costs.

Since the new reference rates are not economically equivalent to each other or to LIBOR due to being based on different data (see Table above), risk management will also be affected fundamentally. Economic hedging relationships must be questioned as basis risk may arise. This is the case, for example, if the hedging transaction and the underlying transaction are not or cannot simultaneously be converted into the new RFRs. In addition, the changes may also lead to operational risks so that Treasury employees must be trained accordingly and IT systems must be adapted to the new environment.
So what should corporations do now? The effects of the changes will affect all companies and entail considerable efforts that consume time and resources. Corporations should therefore act in good time and, in the first step, analyze the data fields concerned in order to be able to derive specific measures for the contracts, processes and systems involved. This should happen regardless of the fact that the new regulations are not yet final and possibly subject to further changes.

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The Treasury platform of the future

Going API

Finance- and Treasury Management Switzerland

It is not further surprising that company CIOs and IT architects have preferred to use a limited number of systems and tools by reining in the multitude of possibilities. The motto was maximum integration with as few interfaces as possible because connecting two IT systems and being sure that these will function smoothly and without a hitch is always a balancing act. At least, this is the case if you use obsolete procedures. Or if you are forced to use them because the systems cannot function otherwise. Consider carefully all of the places to where your Treasury tools are exporting information, saving data, unencrypted and to where it is being imported. Even if it happens more or less automatically and securely, it is nonetheless interface technology of the last century.

Interfaces are so old school – APIs rule

But just why should APIs now be the be all and end all? Why are they not infrequently called game changers and transformation enablers? After all, it's a concept that has been in existence for several decades.

Technically, APIs ("Application Programming Interfaces") are nothing but a number of routines and standards with which the applications or modules communicate or exchange information. As is so often the case, the key to success is the standardization because the way systems and modules interact, how they mutually access functions, data, user interfaces or other elements is of no importance to the general user. The user does not have to worry about this because everything takes place in the background and the expensive and time-consuming interface implementation is no longer necessary. The advantages are obvious – after all, individual systems, system landscapes and ultimately entire platforms can be modularized into individual components with the help of APIs. Do you remember the vision of the modular system where the user can cherry pick the best tools and services from an array of excellent tools and services?

So what's all the hype?

One of the application possibilities of APIs with the greatest potential benefits for treasurers was designed by the regulator itself with the PSD2 (Payment Service Directive). The obligation of banks to

provide APIs for account information and payment operations not only creates completely new opportunities to integrate real-time information into treasury processes but also a new market of providers that could add value – regardless of whether this is for traditional retail banks, Treasury Management Services (TMS) providers or FinTechs. The only important thing is that all of these services can be integrated into your processes and systems. Thanks to APIs!
In the end, the PSD2 is only one of many examples how APIs can be used in Treasury. It is only with the creation of market-ready solutions based on cloud technologies that Software as a Service (SaaS) really has started to make sense for treasurers in the long-term in order to address a number of fundamental difficulties, such as the numerous manual steps in merging data and different systems or the long implementation cycles when introducing new IT tools. Fast, simple and cost-efficient are the words that come to mind when thinking about tapping the potential of APIs. There are many sensible application areas, beginning with the simplest automation steps in Treasury all the way to complex topics in risk management, questions concerning funding or along the process chain for payment operations, to name only a few possibilities.

Become the master builder in your treasury universe

It is therefore an obvious next step to think of the increasing number of FinTechs and their offers of innovative tools and services when discussing APIs and the cloud. However, from a treasurer's perspective, APIs will also revolutionize the market of providers. This concerns banks, market data sellers and TMS producers equally. Surprisingly, it is the banking universe that is pioneering APIs with their concept of "open banking". For instance, the Global Payments Innovation (GPI) initiated by SWIFT and the related tracking service for payments are technologically based on bank-provided APIs. Providers of Treasury Management Services will also not be able to ignore these developments. But never fear: future treasury platforms will not look like complex puzzles of individual cloud solutions that will autonomously manage processes through mysterious communication channels. In essence, every treasurer will continue to require a TMS as a central element for bundling the risks to be managed. However, the trend to modularize and open up the systems can no longer be stopped, as the provision of open APIs has already become a standard. It is best to skate around providers who still offer outdated interface technologies, such as data transfers or similar, and cannot present a substantial API strategy.

It should have become clear by now that the treasury platform of tomorrow will be API-based and seamlessly integrate the additional services required "as a service" on the basis of an open core (TMS). This also applies to the pricing, because why should you pay for something that in the end, you only use parts of? In conclusion, our advice to treasurers therefore is that it is important that they make this universe of systems and services their own and to actively pursue their own API strategy. The first step is an evaluation of where which service is needed and which technology could provide real added value. The possibilities will be nearly infinite – truly a new world!

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