Our preparations for LIBOR reforms

Frequently asked questions

June 2022

- On 5 March 2021, the UK's Financial Conduct Authority (FCA) announced the dates on which LIBORs will cease to be provided or cease to represent their underlying market (see Appendix A).
- GBP LIBOR has been replaced by the Sterling Overnight Index Average (SONIA), while USD LIBOR is being replaced by the Secured Overnight Financing Rate (SOFR). LIBORs in other currencies have been replaced by respective risk-free rates (RFRs). Most GBP LIBOR settings ceased at the end of 2021; however, three settings continue to be published exclusively for use in legacy transactions, with regulatory approvals reviewed annually. USD LIBOR cessation is planned for the end of June 2023.
- M&G has a company-wide project team to manage the transition from LIBOR and the other IBORs to the respective replacement rates.
- Any effect on the value of your investments, at the time the change occurs, is expected to be minimal, and we undertake not to introduce inferior terms to our clients resulting from this process.
- You do not need to take any action. We will communicate to you, as may be deemed appropriate, any material impact on your investments if they arise.

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested. Where past performance is shown, please note that this is not a guide to future performance.

Overview

What are the LIBOR reforms?

LIBOR stands for the London Interbank Offered Rate and it was the main interest rate (or more specifically, a family of interest rates) at which banks lent to each other on a short-term basis. LIBOR was a mainstay of financial markets for more than thirty years. Since its introduction, financial contracts have used LIBORs as a reference to determine interest rate payments.

LIBOR ceased to be published on a representative basis for twenty-four settings as at the end of December 2021. The remaining key USD LIBOR settings have been extended until the end of June 2023. LIBOR replacements include SONIA, which has replaced GBP LIBOR, and SOFR, which is replacing USD LIBOR. The suitability of these RFRs has been assessed through industry-wide consultations.

Why is LIBOR being withdrawn?

In the view of financial authorities, LIBOR presents several issues:

- In the aftermath of the 2008 financial crisis and subsequent changes to the underlying structures of financial markets, LIBOR became a rate at which banks did not lend to each other and there was a consequent lack of transactions.
- LIBOR is a risk to financial stability. Pricing hundreds of trillions of dollars of financial instruments rested on the judgment of relatively few individuals, based on a very small base of unsecured interbank transactions.
- Prior to the introduction of benchmark regulations, there was scope for LIBOR manipulation.

What are SONIA and SOFR?

Introduced in 1997, SONIA has historically been used as a benchmark for overnight unsecured transactions denominated in sterling. SONIA is a measure of the rate at which interest is paid on eligible sterling-denominated deposit transactions. Since April 2016, SONIA has been administered and published by the Bank of England.

SONIA was selected by the Working Group on Sterling Risk-Free Reference Rates as GBP LIBOR's replacement primarily because it is based on an active, liquid underlying market, which makes it a stronger interest rate benchmark.

SOFR was selected as USD LIBOR's replacement in 2017 by Alternative Reference Rates Committee in the US. It bears similar characteristics to SONIA in that it is a transactions-based overnight rate. SOFR is published and administered by Federal Reserve.

How do SONIA and SOFR differ from LIBOR?

SONIA and SOFR are backward-looking, transactions-based benchmarks that reflect overnight lending in the wholesale market. This means they are very nearly risk-free, as there is no in-built term (liquidity) premium or credit premium

Conversely, LIBOR is forward-looking and covers multiple currencies, with its calculation containing credit and liquidity risk premiums. In addition, the SONIA and SOFR interest rate period conventions differ in the sense that interest is only calculated nearer the payment date, whereas LIBOR includes tenors up to 12 months.

Which other replacement rates are being introduced?

Other LIBOR panels are being replaced by the following RFRs:

- EUR LIBOR is being replaced by Euro Short Term Rate (ESTR)
- JPY LIBOR is being replaced by Tokyo Overnight Interbank Offered Rate (TONAR)
- CHF LIBOR is being replaced by Swiss Average Overnight Index Rate (SARON)

Further details are provided in Appendix A.

Is the original timetable for IBOR cessation still in place?

LIBOR has ceased to be published on a representative basis for twenty-four settings as at the end of December 2021. The remaining key USD LIBOR settings have been extended until the end of June 2023. The USD LIBOR extension will afford more time for contracts based on USD LIBOR to mature and give the industry more time to make adequate preparations for the final transition. Additionally, synthetic LIBOR rates (for certain sterling and yen maturities) have been approved by the regulator for continued use on legacy contracts for a time bound period – currently the end of 2022.

Currency and tenor	Cessation date
Sterling: overnight, one week, two months, 12 months	31-Dec-21
US dollar: one week, two months	31-Dec-21
US dollar: overnight, 12 months	30-Jun-23
Japanese yen: overnight (spot next), one week, two months, 12 months	31-Dec-21
Euro: all	31-Dec-21
Swiss franc: all	31-Dec-21

Currency and tenor	Unrepresentative from
Sterling: one month, three months, six months	31-Dec-21
US dollar: one month, three months, six months	30-Jun-23
Japanese yen: one month, three months, six months	31-Dec-21

Source: Bank of England, Federal Reserve Bank of New York, European Central Bank, SIX Swiss Exchange Ltd, Bank of Japan, , March 2021.

Effects on funds and investments

How does the transition from LIBOR to new RFRs affect the funds I am invested in?

There are three principal ways that a fund may be affected by the change from the existing LIBOR rate:

1. The fund or mandate holds investments whereby the value of the asset, or cashflows it generates, are currently specifically linked to LIBOR or another IBOR. Examples would include floating rate notes or asset-backed securities. Over time, the fund's composition will change to holding new securities that have cashflows linked to the new RFR.
2. The fund or mandate has a performance benchmark, or an objective, that is linked to a LIBOR interest rate, or another IBOR. An example might be a fund which has a performance benchmark of three-month GBP LIBOR. We will look to change the fund's performance benchmark to a suitable alternative, most likely the replacement RFR.
3. The performance fees charged to the fund are linked to one of the IBOR rates that are changing.

In the run-up to GBP LIBOR's cessation at the end of 2021, M&G addressed the second and third impacts listed above. Product benchmark and performance fee transitions from LIBOR to RFRs and alternative rates are now complete. The impact on investments continues to be tracked and managed.

When will the changes take effect?

Most IBORs ceased on 31 December 2021 as planned; however, USD LIBOR will continue until 30 June 2023 for most tenors. At M&G, we are working hard to ensure the process of making necessary changes is smooth and has as little of an effect on clients as possible. We have adopted a timetable that we believe is appropriate for this.

How does M&G intend to calculate the spread between new RFRs and their IBOR predecessors?

A key methodology to determine the spread between an IBOR and its replacement RFR is the credit spread adjustment specified in the IBOR ISDA Fallbacks Protocol, published by the International Swaps and Derivatives Association (ISDA), and the subsequent IBOR Fallbacks Supplement. M&G adhered to this protocol in January 2021, which means this methodology applied to fallbacks on all our non-USD LIBOR swaps and derivatives positions following 31 December 2021. The fallbacks will apply to USD LIBOR following the planned cessation of 30 June 2023.

M&G will use the credit spread adjustment rate supplied by Bloomberg, the acknowledged data provider of this rate.

M&G's preparations

What progress has M&G made in its LIBOR transition?

In March 2019, M&G put in place a programme and significant resources to manage the transition to new rates with a minimal effect on clients.

The M&G IBOR programme has focused on:

1. Identifying and managing the effect on the assets we manage.
   - A We are tracking the IBOR exposures of the assets we manage on a monthly basis. This data helps us to understand the extent to which our fund managers are moving away from IBORs and adopting the new RFRs. Post December 2021 and the cessation of GBP LIBOR, we also track our exposure to synthetic LIBORs, the use of which has been permitted by the regulator for a time-bound period.
   - B M&G analysts and fund managers continually seek to progress the transition away from IBORs by decreasing IBOR exposures where we believe it is in the clients' best interest.
   - C We actively engage our fund managers to ensure a governance process is in place for investments in IBOR assets.
   - D Private asset deal teams within M&G have completed the transition on the vast majority of legacy GBP LIBOR lending deals and continue to work on transitioning USD LIBOR and synthetic GBP LIBOR legacy deals.
2. Identifying and understanding any effects on our products.
   - A Product teams within M&G have completed replacing IBOR references for product benchmarks and performance fees.
   - B We have updated marketing materials and product prospectuses in line with the above changes
   - C We have updated our investment management agreements (IMAs), which contain references to LIBOR or another IBOR. These have been redrafted and bilaterally agreed with clients where applicable.
3. Identifying and understanding the effects on our operations and systems.
   - A Following an assessment of M&G's internal systems, we confirm the effects are minimal and do not pose any material risks to the business.
   - B Our third-party suppliers and system vendors all have significant IBOR programmes in place, and we have engaged with them to understand their operational readiness. We have identified key areas to monitor and engage and we will continue to oversee our suppliers.
   - C Our operational teams have reviewed their processes and, where potential issues have been identified, we have plans in place to ensure any effects on our operations are minimised. M&G is already operationally capable of supporting the new RFRs. We have been trading in instruments that link to the new RFRs and some legacy instruments have already transitioned away from LIBOR.

4 Actively participating in industry engagements.

A We actively engage in industry discussions around IBOR transitions in relation to remaining deliverables through industry associations and industry working groups. This enables us to stay informed of any ongoing regulatory and market developments.

B We maintain a close and continuous dialogue with our FCA supervisors and other regulators regarding the progress of the transition process.

C We carefully consider whether consultations regarding IBOR transition affect our clients and respond accordingly.

D Our industry engagements help to inform the actions we take to accommodate IBOR transitions and remaining exposures with the aim of ensuring optimal outcomes for our clients.

Does M&G foresee any issues with removing IBOR references from assets or products?

Assets

Where M&G invests in IBOR-linked public assets, such as bonds or floating-rate notes, we endeavour to engage actively with issuers to understand their IBOR transition plans. In many cases, we are dependent upon issuers to enact changes to replace IBOR references for these securities.

Where we hold loans, we are working with or will endeavour to work with borrowers and their agents to make the appropriate deal term amendments to accommodate IBOR cessations. In this process, we depend on consent from the borrower and often from other lenders. Our legacy GBP LIBOR exposure on lending deals has already been transitioned, with a few remnants currently on synthetic LIBOR. We are progressing the transition of remaining synthetic LIBOR and USD LIBOR exposures within private lending.

Regarding LIBOR exposure in derivatives, M&G has signed up to the ISDA Fallbacks Protocol in line with our major swap counterparties. Much of our GBP LIBOR derivative exposure transitioned at the end of 2021 in line with this protocol and the cleared swap conversion conducted by the London Clearing House. The transition for USD LIBOR swap exposure will take place using the same protocol and clearing house procedures.

Products

We have completed the transition of all LIBOR-linked product documentation to RFRs and alternative rates.

How will M&G communicate with its clients?

We have communicated with clients throughout 2020 and 2021 as we completed our transition of LIBOR-linked products.

We will continue to communicate with clients regarding any material impacts as a result of changes to any to the underlying LIBOR-linked assets of these products.

Does M&G depend on any market initiatives to help it prepare for IBOR cessations?

The IBOR transitions are occurring internationally and being driven by market participants and several regulatory bodies. We have actively engaged in industry discussions regarding the transition approach and forming market conventions for the future use of RFRs.

Most of the key dependencies were resolved in the run-up to GBP LIBOR cessation at the end of 2021. Consequently, the approach to managing the USD LIBOR transition has benefitted from the work carried out over previous years.

We continue to participate in and observe industry initiatives concerning the transition from USD LIBOR and the use of replacement RFRs in new issuance. Some of these initiatives are set out below.

New issuance

1 Conventions for interest calculations.
2 Forward looking term rates.
3 Fallback documentation (for IBOR contracts to fall back to RFRs).

Legacy transitions

1 The credit spread adjustment (i.e. the increment, usually given in terms of basis points, or one-hundredths of a percentage point) to apply to an RFR to make it equivalent to the IBOR it is replacing. As of 5 March 2021 the International Swaps and Derivative Association (ISDA) has already published these spreads based on a defined methodology and, while these are applicable to swaps, they provide indicative numbers used by issuers for transitioning cash instruments.
2 Standardising the legal language relating to converting an IBOR referencing contract.
3 Standardising the legal language to convert an IBOR-related contract by way of a fallback i.e. when the IBOR ceases to be published.

4 Tough legacy solutions i.e. contracts that cannot be amended easily and require an alternative, potentially legislative, solution.

Please see Appendix B for more information.

In addition to market initiatives, we have also taken note of legislation in the US that puts in place automatic fallbacks on USD LIBOR contracts that satisfy specific criteria. Our assessment of the applicability of such legislative fallbacks is considered by our investment teams in their approach to reducing or transitioning remaining IBOR exposure.

Other information

How are the market initiatives governed and what is M&G's role?

Market initiatives in sterling markets are governed by the Working Group on Sterling Risk-Free Reference Rates (RFRWG). This was established by the Bank of England to coordinate the transition, and it is responsible for producing reports and making recommendations to market participants. The Bank of England is an ex officio member, and the group itself is chaired and attended by private sector actors.

M&G is one of five asset managers on the RFRWG out of a total of 26 private sector attendees. M&G co-chairs two of the five RFRWG sub-groups. The RFRWG had completed most of its objectives as at the end of 2021.

How has the industry coordinated internationally?

The regulators work closely on developing solutions to the issues raised in the IBOR transitions process, particularly the Bank of England and the Federal Reserve Board in the US. The Alternative Reference Rates Committee (ARRC) is the US version of the RFRWG. Meetings held by the ARRC are attended by RFRWG representatives, and vice versa, who give updates of the respective markets so that approaches to market initiatives can be aligned or made to differ where appropriate.

Appendix A

Current reference rate		Cut-off date	Expected alternative		First publish date of alternative	Alternative rate supervisor
GBP LIBOR	London Interbank Offered Rate	31 Dec 2021	SONIA	Sterling Overnight Index Average **(unsecured)**	23 April 2018	Bank of England
USD LIBOR	USD London Interbank Offered Rate	30 June 2023 (except 31 Dec 2021 for one-week and two-month USD LIBOR)	SOFR	Secured Overnight Financing Rate **(secured)**	3 April 2018	Federal Reserve Bank of New York
EONIA and EUR LIBOR	Euro Overnight Index Average / Euro London Interbank Offered Rate	31 Dec 2021	ESTR	Euro Short Term Rate **(unsecured)**	2 October 2019	European Central Bank
CHF LIBOR	CHF London Interbank Offer Rate	31 Dec 2021	SARON	Swiss Average Rate Overnight **(secured)**	December 2017	SIX Swiss Exchange Ltd
JPY LIBOR and TIBOR	JPY London Interbank Offered Rate / Tokyo Interbank Offered Rate (TIBOR) (derivatives only)	31 Dec 2021	TONAR	Tokyo Overnight Average Rate **(unsecured)**	December 2016	Bank of Japan

Source: Bank of England, Federal Reserve Bank of New York, European Central Bank, SIX Swiss Exchange Ltd, Bank of Japan, , March 2021.

Appendix B

Additional information concerning market-wide initiatives and standards that M&G depends on.

New issuance

1. Conventions for interest calculation refers to the conventions for constructing an RFR-linked contract and the terms and technical details around calculating interest and payments on these.
2. Forward-looking term rates refer to the adjustment of the RFR to be forward- rather than backward-looking. This is done by taking data from overnight RFR swap markets and extrapolating them over term periods to match the IBOR e.g. one month, two months, three months, six months and 12 months. In contrast to the normal use of RFRs as rates compounded in arrears, forward-looking term rates set out the interest payment at the start of the interest period, rather than at the end. As such, the rate is not as robust, as it is derived from a calculation on one day rather than several days, unlike rates compounded in arrears. The forward-looking term rates are deemed inappropriate for only a small section of the sterling markets.
3. Fallback documentation refers to the standardised legal language in a new IBOR issue, such that its fallback language allows it to smoothly transition to a different rate once that IBOR ceases.

Legacy transitions

4. Credit spread adjustment refers to the value to be applied to achieve equivalence between an RFR and its respective IBOR. This credit spread is required because IBORs are forward-looking rates that build in a bank's credit risk, whereas the new rates are risk free. As a result, an IBOR tends to be a higher rate than an RFR. As of 5 March 2021, ISDA has already published spreads based on its methodology and, while these are applicable to swaps, they provide indicative numbers used by issuers for transitioning cash instruments
5. Standardising the legal language to actively convert an IBOR contract refers to the process by which an existing contract is amended to replace the IBOR reference with an RFR reference. In bond and loan markets, each contract is a unique, so this process can only be standardised to a certain extent. However, due to the number of contracts in sterling markets, standardising this language is important to ensure that firms have the technical and legal capacity to convert the large quantity of contracts in a regulatory compliant and fair way.
6. Standardising the legal language to convert an IBOR contract by way of a fallback refers to amendments to the fallback terms of a contract, such that it converts to an RFR when the IBOR ceases to be published. As opposed to the above, this would allow the contract to convert at a later date and may be preferable, for example, if the contract is hedged.
7. Tough legacy solutions refer to legislative solutions required to convert certain IBOR contracts. This would be if there were no reasonable means to convert the contract, including contracts with multiple parties that need 100% consent to amend, or asset-backed securities with no deal sponsor to initiate a consent solicitation.

What is the ISDA 2020 IBOR Fallbacks Protocol?

Following multiple market-wide consultations in 2018-2020, an agreed method of calculating the difference between an RFR and a respective IBOR was agreed in the derivatives markets by ISDA. This methodology involves calculating the median difference between the IBOR and the RFR over a five-year period. This difference is known as a credit spread adjustment and called the 'ISDA spread'. It may differ from market to market and is calculated by Bloomberg.

The ISDA Fallbacks Protocol amends the language on existing bilateral swaps, almost all of which are governed by ISDA. This creates a legal mechanism by which, once an IBOR ceases, the contract automatically begins calculating interest based on the RFR in addition to (or reduced by) the ISDA spread. The shorthand for this mechanism is the 'ISDA fallback'.

Concurrently to this, ISDA amended its 2006 ISDA definitions, effective from 25 January 2021, which will govern all new swap transactions. New contracts will therefore by default have built-in ISDA fallbacks to replace IBOR once the rate ceases.

For Investment Professionals, Institutional Investors and Professional Investors only. Not for onward distribution. No other persons should rely on any information contained within.

768003 / JUN 22_EUR /AT_DE_HK_SG_TW