

The end of LIBOR and the arrival of SARON

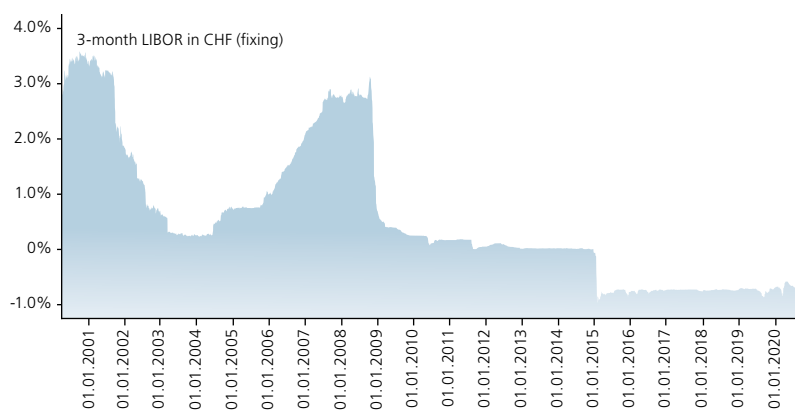
Following the announcement by the UK Financial Conduct Authority on 27 July 2017 and 5 March 2021, the London Interbank Offered Rate (LIBOR) in Swiss francs was discontinued at the end of 2021. This decision had an impact on the Swiss market for loans to individuals and companies indexed to the LIBOR. BCGE now offers its clients loans indexed to the Swiss Average Rate Overnight (SARON).

What is the background?

LIBOR is the average rate at which banks are willing to lend unsecured funds to each other. It is administered by the ICE Benchmark Administration (IBA) and is calculated as an average of the interest rates provided by selected panel banks. It is calculated in five currencies (USD, GBP, EUR, CHF, JPY) and a range of maturities (ON/SN, 1W, 1M, 2M, 3M, 6M and 12M).

LIBOR is the most widely used benchmark interest rate and serves as basis for determining the prices of a broad range of financial instruments, such as loans, bonds, and derivatives.

Evolution of the 3-month CHF LIBOR since 1 January 2000



Source: Bloomberg

Why abandon LIBOR?

The calculation of the LIBOR in Swiss francs is based almost exclusively on estimates by experts and not on actual transactions. The Financial Conduct Authority (FCA), the regulatory authority supervising the LIBOR administrator, announced that the LIBOR interbank rate would no longer be updated for the euro and the Swiss franc, as well as for certain dollar, yen and sterling maturities from 31 December 2021. A switch to an alternative reference rate for the Swiss franc was inevitable.

What are the alternatives to LIBOR?

The National Working Group (NWG)¹ on reference rates in Swiss francs is the committee responsible for promoting the transition to an alternative reference rate to Swiss franc LIBOR and for assessing the latest international developments. The presidency of the NWG is held jointly by a representative of the private sector and a representative of the Swiss National Bank (SNB). Participation in this working group is also open to other important stakeholders and financial market players, including BCGE.

The working group recommended that the SARON (Swiss Average Rate Overnight) be used as a replacement interest rate. The SARON is an overnight interest rate based on data from the secured Swiss franc money market, also known as the “REPO market” for repo transactions (Sale and Repurchase Agreement).

What is SARON?

The Swiss Average Rate Overnight (SARON) reflects the conditions for overnight transactions in the secured Swiss franc money market. It is administered by SIX Swiss Exchange (SIX).

The SARON is calculated as a volume-weighted average of transactions and binding quotes in the order book of SIX's electronic trading platform. The methodology, which was developed in coordination with the Swiss National Bank (SNB), is transparent and publicly available.

The SARON is calculated immediately after the market has closed (6 pm) with further fixings during the day at 12 noon and 4 pm. The SARON is based on the 6 pm fixing close.

The SARON's fixing mechanism has a clear governance structure that complies with international benchmark standards. At the beginning of 2017, SIX founded the Swiss Reference Rates Index Commission, which regularly reviews all aspects of SARON in CHF.

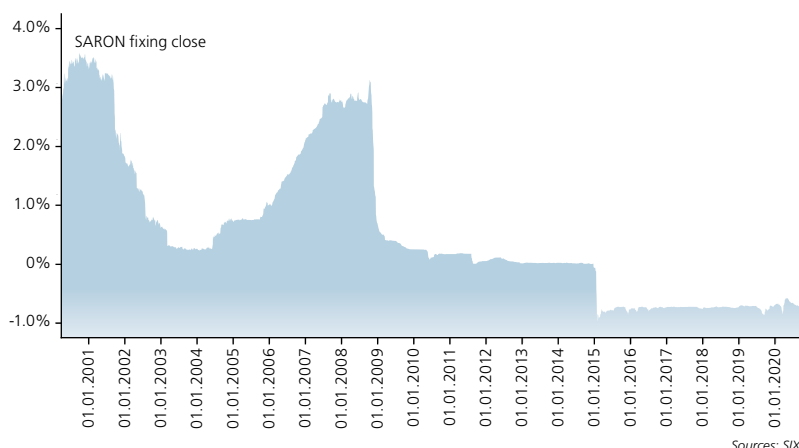
What are the main characteristics of SARON?

The main characteristics that make SARON an alternative benchmark index to LIBOR in Swiss francs are as follows:

- 1 it is **representative** because it is based on **actual transactions**;
- 2 it is **robust** because it is based on the REPO market and its **methodology** is **transparent** and accessible to the public;
- 3 it is **administered by SIX** which operates the infrastructure for the Swiss financial centre in full compliance with benchmark regulations.

All these characteristics reinforce the National Working Group's decision to recommend SARON to replace LIBOR in Swiss francs. The historical SARON rates are available on the SIX website².

Evolution of the SARON since 1 January 2000



¹ https://www.snb.ch/en/ifor/finmkt/finmkt_benchm/id/finmkt_reformrates

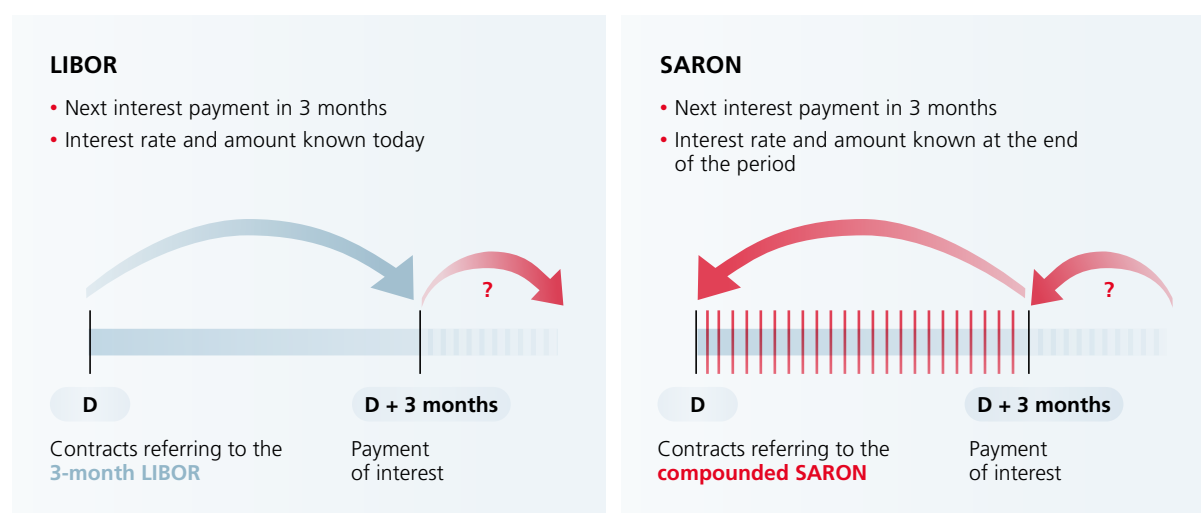
² https://www.six-group.com/exchanges/indices/data_centre/swiss_reference_rates/reference_rates_en.html

What is the compounded SARON and why is it important?

If a forward rate such as the three-month LIBOR is used as a benchmark rate in a financial transaction, the interest payments are already known at the beginning of the interest calculation period. This type of forward rate reflects the expected interest rate level for the next three months and corresponds to a sequence of expected overnight rates.

The SARON is a reference rate for overnight transactions. Consequently, SARON cannot be used for loans with a maturity of more than one day. The National Working Group therefore recommends using the compounded SARON in accordance with the approach described on the SIX administrator's website.

If the compounded SARON is used as the reference rate for loans, the interest payments are based on the daily compounded interest rates. Whether or not interest payments are known at the beginning of the interest calculation period depends on how a compounded SARON is applied.



How is the SARON used for financing?

The National Working Group has proposed six variants for using the compounded SARON in financing. They have been defined in order to respond to the specificities as well as to the constraints of introducing financial products and apply the following concepts:

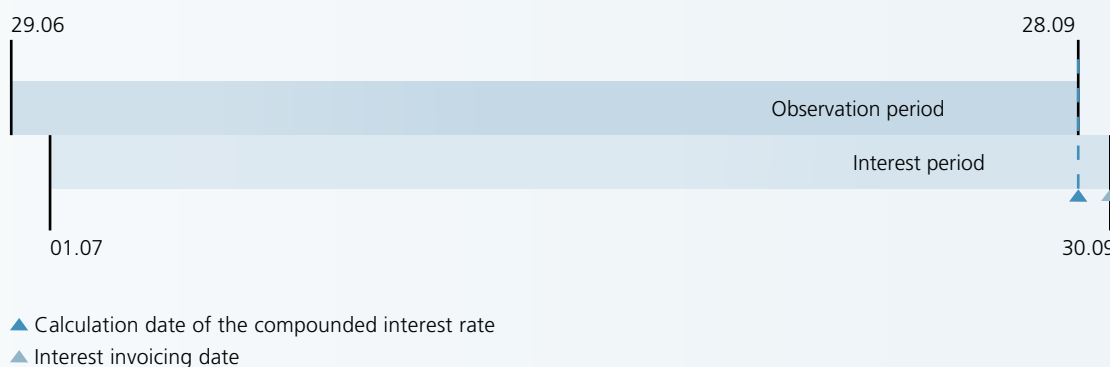
- an "observation period" during which a real SARON fixing sequence is observed and used for the calculation of the compounded SARON;
- an "interest period" during which the loan capital is taken into account for the calculation of interest.

The main variants used in financing are the following:

“Plain”: for which the “observation period” and the “interest period” coincide;

“Lookback”: for which the “observation period” is of the same duration as the “interest period” and is anticipated by a few days in order to allow, among other things, for processing interest statements that are invoiced on the end date of the “interest period”.

Lookback variant (2 business days)




How to follow the evolution of SARON?


The main Swiss reference rates, including the SARON, can be consulted on the website of the administrator SIX Swiss Exchange. The compounded SARON interest rate can be calculated by means of a calculator³ provided by the SIX Swiss Exchange administrator.

³<https://www.six-group.com/en/products-services/the-swiss-stock-exchange/market-data/indices/swiss-reference-rates/saron-calculator.html>

Contact

 Your personal adviser

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