

Responses to Market Participants' Feedbacks on Adjusted THBFIX Consultation

The Bank of Thailand (BOT) has received feedbacks on the consultation of Adjusted THBFIX from both financial institutions and corporates. The BOT, on behalf of the steering committee on commercial banks' preparedness on LIBOR discontinuation (the committee), would like to thank market participants for your feedbacks, including both concerns and suggestions. In this regard, we would like to provide our responses to such concerns and hope that it will address any and all issues and bring mutual understanding on this subject.

Feedback Results: Most respondents agreed to all the committee's proposals as the methodology is consistent with international practices, particularly for cross-currency products. To briefly reiterate the proposals, in the case of a permanent cessation of USD LIBOR, the Secured Overnight Financing Rate (SOFR) compounded in arrears (Adjusted SOFR) plus the fixed spread calculated from 5-year lookback period prior to the occurrence of a trigger event will replace USD LIBOR in the calculation of the THBFIX fallback (Adjusted THBFIX). The convention in using Adjusted THBFIX in derivative products will require that market participants observe the rate published 2 business days prior to the payment date for any interest period, which is in line with other currencies' practices.

Concerns and Responses: Below is a summary of the concerns raised by respondents, as well as the committee's responds to those issues.

Concerns/Suggestions	Responses
<p>Methodology</p> <p>The calculation methodology is quite complex and could result in significant difference from the existing THBFIX.</p> <p>Moreover, the fixed spread may not fully reflect the full economic cycle and also may not represent market conditions over the next few</p>	<p>Although the proposed methodology seems to be complicated and change the characteristic of Adjusted THBFIX from the existing rate, this method is agreed upon by most global market participants as the best available solution. With regard to the complexity in the calculation, the BOT, as the</p>

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<p>years during the transition period (the period for which Adjusted THBFIX will be used).</p>	<p>administrator of THBFIX, will ensure the fairness and accuracy of published rates.</p> <p>It is true that a fixed spread adjustment may not represent market conditions over the next few years. In this regard, THOR, a new THB interest rate benchmark, is an alternative reference rate that could better represent local market conditions and help avoid the influence of USD liquidity going forward. Therefore, the BOT encourages market participants to reference THOR when applicable.</p>
<p>Payment preparation</p> <p>Adjusted THBFIX will be known at the end of the interest period. This means that there may not be sufficient time to prepare payments. Although the committee proposed to observe Adjusted THBFIX 2 business days prior to the payment date, it still could be insufficient due to the internal payment approval processes.</p> <p>One respondent proposed using Adjusted THBFIX compounded in advance instead (if possible) in order to avoid cash flow uncertainty.</p>	<p>As the global interest rate benchmark development proceeds towards the usage of overnight rate compounded in arrears, it is inevitable that the interest amount will only be known at the end of each interest period. Hence, market participants need to adjust their relevant processes and practices to support this development, not only for THB interest rate, but for other currencies' interest rates as well.</p> <p>The proposal to observe Adjusted THBFIX published 2 business days prior to the payment date in the consultation aims to set a standard convention for derivative contracts under the ISDA agreement.</p>

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	<p>Meanwhile, market participants can approximate the full payment prior to the Adjusted THBFIX publication, based on SOFR which is normally not very volatile and the spot and swap rates which are known well in advance.</p> <p>For cash products, market participants may negotiate bilaterally with their counterparts on how to reference Adjusted THBFIX by balancing between the costs and benefits of each option. For example, applying Adjusted THBFIX of the previous interest period to the current interest period (compounded in advance) could avoid cash flow uncertainty, but result in a mismatch between the interest period and the interest reference period. Moreover, this will be an ineffective hedge with corresponding derivatives contracts.</p>
<p>Adjusted THBFIX IRS and CCS convention</p> <p>One respondent asked for the clarification of market conventions of Adjusted THBFIX IRS and CCS.</p>	<p>The only change in the convention of IRS and CCS when referencing Adjusted THBFIX is the fixing date. The new one is 2 business days prior to the payment date.</p>
<p>Infrastructure</p> <p>The current IT systems don't support the compounded setting in arrears rate. This change requires resources to develop the new systems</p>	<p>The detailed calculation methodology of Adjusted THBFIX will be provided on the BOT</p>

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<p>and it would take time especially for small corporates.</p> <p>One respondent asked for the industry's cooperation in communicating the requirement to system vendors.</p>	<p>website to assist a clear communication to system vendors.</p> <p>However, the requirement of system alteration may be different across banks and system vendors. Therefore this task should be handled by each bank respectively, and banks should begin their internal processes promptly.</p>
<p>Communication</p> <p>Some respondents suggested that there is a need for a guideline for contract amendments with customers and an early engagement with end-users to mitigate any confusion and potential issues.</p> <p>One respondent also mentioned that the lack of understanding on the impact of THBFIX could lead to disputes during the transition to Adjusted THBFIX.</p>	<p>The BOT, together with the committee, will publish the guideline of contract amendments for cash products later this year. The communication to create awareness and understanding for clients has been planned and is ongoing. In this regard, banks' cooperation is strongly required to achieve a desirable outcome.</p>
<p>Transition</p> <p>One respondent preferred a one-time transition from THBFIX to THOR (a new THB interest benchmark) if possible.</p>	<p>The proposed transition to Adjusted THBFIX will be applied for legacy derivatives contracts under ISDA agreement. Non-ISDA agreements may opt for a transition to THOR. However, during the early stages of THOR development when liquidity is still low, this approach demands extra costs. In this regard, the committee will consider providing a</p>

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	guideline or any useful information to ensure the smooth transition.
<p>Accounting</p> <p>As Adjusted THBFIX is a backward looking rate, it is difficult to estimate daily accrual incomes and expenses. This might lead to inconsistencies in accrual recognition amongst market participants. One respondent proposed the publication of the rate to be used for revenue recognition.</p>	<p>These issues have yet to be concluded at this stage. The BOT and the committee will work with relevant experts, such as the Federation of Accounting Professions of Thailand, to seek for the clarification or guidelines for common practices (if applicable) to facilitate the transition.</p>
<p>Risk and Valuation</p> <p>The change in the rate property from forward-looking to backward-looking has significant impacts on risk measurement, mark-to-market valuation, and calculation model.</p> <p>Some respondents requested for a common practice.</p>	
<p>Limitation of Adjusted THBFIX in other cases</p> <p>Due to its backward-looking characteristics, Adjusted THBFIX may not be applicable for some contracts/products currently referencing THBFIX, for example:</p> <ul style="list-style-type: none"> - A contract refers to a particular tenor of THBFIX which differs from its interest period, e.g. referring to 6M THBFIX where its interest period is 3 months. - A product for which a forward-looking term rate is required, e.g. trade finance. 	<p>Adjusted THBFIX will not be able to serve contracts/products which require a forward-looking term rate. Market participants should switch to more suitable reference rates.</p> <p>In the future, a forward-looking term rate fixed from THOR overnight interest rate swap (OIS) could be considered as another option, depending on the success of its current development plan.</p>