CLEARY GOTTLIEB

Finance & Restructuring – 2020 Year in Review

February 2, 2021

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COVID-19: The Impact on Corporates and Debt Documentation

The coronavirus pandemic posed a considerable challenge to corporate borrowers seeking to preserve liquidity and access additional funds in the face of falling revenues in 2020. Bond issuances by large corporates soared whereas, in comparison, syndicated loan transactions trailed for most of the year in a constrained market. This year also saw an up-tick in hybrid investments, including in connection with the acquisition of the ThyssenKrupp elevator business in early 2020. Given their more bespoke terms and lack of homogenization comparative to other investments, the adaptability of hybrid instruments may see them proliferate post-COVID-19.[1] Following record debt issuances in the first half of the year, many companies have focused on repaying, refinancing or reducing debt (including through liability management transactions) scheduled to mature in the short to medium term.

As the year progressed, borrowers facing covenant compliance issues sought consent requests proposing covenant amendments to address liquidity concerns and the impact of the pandemic on their business. These consents come in various forms such as the suspension or loosening of financial covenants for a defined holiday period, the addition of carve-outs under the debt covenant and the addition of incremental debt capacity to permit borrowers to raise additional financing and amending the "Material Adverse Effect" definition to exclude the impact of the pandemic. While lenders may have provided debtors with a temporary reprieve, the quid-pro-quo included the imposition of additional obligations such as the introduction of liquidity covenants and additional financial reporting covenants.

Noteworthy terms that came to market in 2020 included broad addbacks to consolidated net income or EBITDA for non-recurring, exceptional, one-off and extraordinary costs and losses resulting from COVID-19, uncapped *pro forma* adjustments to the calculation of EBITDA, more permissive ratio calculations, increased room in baskets for the incurrence of additional facilities or permitted alternative debt and increasing permitted investments capacity. We noted in a previous update[2] that, in the past, lenders have been extremely reluctant to exercise their rights in relation to MAE events of default and that their approach was unlikely to change, even in the face of COVID-19 related disruptions. As large UK banks remained well capitalised and supported by government policy in 2020, this translated into a willingness to extend loan waivers and, indeed, a reluctance to call defaults, much less on MACs.[3] There were few reported cases in 2020 relating to enforcement of MAE clauses, and the High Court judgment in *Travelport Ltd and others v Wex Inc* [2020] EWHC 2670 (which did not determine whether a MAE had in fact arisen) reiterated the legal and factual complexities involved in successfully doing so.

[1] See our alert memorandum: Neither One Thing Nor the Other: Hybrid Investments.

[2] See our alert memorandum: COVID-19 – Liquidity and Other Considerations for Borrowers.

[3] See: Global Restructuring Trends for 2021.

Corporate Restructurings: Snapshot of 2020

Globally, governments (as well as central banks, regulators and international financial institutions) introduced a variety of measures to support businesses through the economic shock related to the pandemic. Temporary measures included relaxing insolvency laws, introducing government-backed loans, freezes on loan enforcement and relax regulatory capital requirements for banks. Monetary authorities introduced measures including asset purchase programs, corporate bond purchasing schemes and interest rate cuts.[4]

The UK government implemented major financing schemes to help businesses bridge COVID-19 related disruption to their cash flows. The Coronavirus Business Interruption Loan Scheme ("**CBILS**") and the Coronavirus Large Business Interruption Loan Scheme ("**CLBILS**") offer support to eligible UK companies in the form of business loans, overdrafts, invoice finance and asset finance.[5] The Covid Corporate Financing Facility ("**CCFF**") also provides funding support by purchasing eligible commercial paper issued by non-financial businesses which are considered to make a material contribution to the UK economy.[6] The Bounce Back Loan Scheme ("**BBLS**") supports small- and medium-sized businesses by providing eligible companies with smaller value term loans. The Future Fund provides convertible loans, on a match-funded basis, to businesses driving innovation in the UK. These schemes have been widely utilised and each of the CBILS, CLBILS, BBLS and Future Fund schemes have since been extended to January 31, 2021, while the CCFF will remain open for new purchases from eligible issuers until March 22, 2021. This support allowed many businesses access to emergency funding.

Cleary Gottlieb advised Celsa Group UK which in summer became the first company to access the UK government's special emergency funding for strategically important companies. The restructuring involved the negotiation of a bespoke facility agreement with the UK government and amendments to Celsa's existing facilities to address the liquidity and other challenges arising as a result of the pandemic.[7] Cleary Gottlieb also advised Codere, the Spanish gaming company, which secured emergency funding during the summer to bridge its liquidity gap to a restructuring and additional capital raise.[8]

[4] See our alert memorandum: COVID-19 Toolkit for Sovereigns: Support, Stimulus and Debt Management Measures.

[5] See our alert memorandum: COVID-19: Coronavirus Large Business Interruption Loan Scheme.

[6] See our alert memorandum: COVID Corporate Financing Facility Explained.

[7] See: Celsa Group UK in Emergency Financing Provided by UK Government.

[8] See: Codere in Refinancing Transaction.

The Corporate Insolvency and Governance Act 2020

The Corporate Insolvency and Governance Act 2020 (the "**Act**") implemented a number of key reforms – including a stand-alone moratorium and a new restructuring procedure (a "**Part 26A Scheme**") – and certain temporary measures to provide UK businesses with breathing space to continue trading through the disruption caused by COVID-19.[9]

The Part 26A Scheme, while closely modelled on the existing scheme of arrangement procedure (which remains available to debtors), allows the court to bind classes of dissenting creditors or shareholders to a restructuring plan ("cross-class cram-down," a familiar feature in U.S. Chapter 11 proceedings) if certain conditions are met. While a Part 26A Scheme also requires the consent of 75% by value of shareholders or creditors, unlike a traditional scheme of arrangement, it does not require the consent of a majority by number of those voting, and the failure of one class of creditors to vote in favour of the scheme is not fatal. It also does not require approval by the majority of unconnected creditors by value, which is required under a company voluntary arrangement.

A potential game-changer for UK restructurings, the Part 26A Scheme, was first utilised by Virgin Atlantic Airways and Pizza Express, although the cross-class cram-down tool remains, to date, untested. The Virgin Atlantic Airways restructuring presented another 'first' for 2020—being the first time a debtor under a Part 26A restructuring plan applied for a restructuring plan to be recognised as a "foreign main proceeding" under the U.S. Bankruptcy Code.

The new corporate moratorium process under the Act provides protection for a distressed company from certain enforcement actions by creditors for an initial period of 20 business days, provided specified conditions are met. However, companies party to certain capital markets arrangements (for example, those with outstanding bonds) are not eligible for the moratorium. In addition, the exclusion of bank debt and certain other financial obligations of a debtor from the benefit of the moratorium, limits the utility of this reform as such debt, for many companies, represents their most material financial obligations.

The Act also implemented a number of other temporary measures to protect businesses and their management teams, including the suspension of wrongful trading liability for directors, prohibition of statutory demands and winding up petitions, rules preventing suppliers from terminating clauses via so-called *ipso facto* clauses and extensions of certain corporate filing deadlines. The temporary suspension of wrongful trading rules was renewed on November 26, 2020 and now applies until April 30, 2021. The time lapse between the first and second suspension of this liability (between October 1 to November 25, 2020) will need to be carefully navigated by courts considering wrongful trading actions against directors in the short term.

9 See our alert memorandum: UK Corporate Insolvency and Governance Bill: A Game-Changer?

Other European countries introduced similar reforms to their restructuring frameworks in 2020. In particular, the new German and Dutch restructuring tools (each in force from January 1, 2021) share many similarities with the English scheme of arrangement procedure and also allow for a moratorium and cram-down of dissenting creditors. Although untested, given that such proceedings might receive automatic recognition under the European Insolvency Regulation, there has been some speculation as whether such schemes would be seen as attractive alternatives to English schemes, post-Brexit.

Brexit: The Impact on Debt Capital Markets and Loans

The EU–UK Trade and Cooperation Agreement ("**TCA**") signed on December 30, 2020 is of limited relevance to financial services and capital markets. Financial services passporting between the EU and UK has ended, with cross-border access between the two markets now governed by their respective third-country regimes including equivalence frameworks in certain areas. The reported negotiations for a further "deal" on financial services (in reality, an agreement to establish a memorandum of understanding setting out parameters for regulatory cooperation by March 2021), if fruitful, are unlikely to change the position in any meaningful respect.

After the end of the Brexit transition period on December 31, 2020 ("**IP Completion Day**"), existing EU law was on-shored as "retained EU law," with amendments to reflect that the UK is no longer a member of the EU, effectively creating UK versions of EU regulations. This includes the implementation of certain aspects of the EU's 2019 revised bank prudential framework which the UK was required to transpose in December 2020, before the end of the transition period.[10] In addition, the UK regulatory authorities have confirmed that certain non-binding EU guidelines and recommendations (for example, EU non-legislative materials) are still relevant, post IP Completion Day. Accordingly, in policy terms, UK law remains largely the same as it was immediately before IP Completion Day and in-step with EU law. However, a broad programme of work has already begun to update the UK's regulatory framework for financial services for the future. Notably, the Financial Services Bill (the "**FS Bill**"), introduced to Parliament on October 21, 2020, proposes extensive reforms to the legislative and regulatory framework for financial services. In respect of prudential regulation, the FS Bill proposes to establish the legislative framework for the Investment Firms Prudential Regime and the implementation of the final Basel III standards for banks. In respect of LIBOR transition, the FS Bill introduces certain amendments to the UK Benchmarks Regulation, to provide the Financial Conduct Authority ("**FCA**") with additional powers to manage an orderly wind-down of LIBOR. As the UK Benchmarks Regulation prohibits referencing benchmarks administered by a foreign country from 2022 unless one of three "access routes" (*i.e.*, equivalence, endorsement or recognition) is used, the FS Bill also proposes to extend the transitional period for third-country benchmarks from December 31, 2022 to December 31, 2025, addressing concerns that foreign benchmark administrators would not make use of these access routes.

Impact on debt capital markets

The UK Market Abuse Regulation ("**UK MAR**") applies to conduct related to financial instruments trading on both UK and EU venues. The general rules on handling of inside information, market soundings, market manipulation and stabilisation continue to apply. Issuers and investors may therefore face the application of dual market abuse regimes. For instance, issuers that have requested, or approved admission to trading or

[10] See our alert memorandum: The UK's Post-Brexit Financial Services Regulatory Framework – HM Treasury Consults on the Transposition of CRD V.

approved trading of their financial instruments on a UK venue, (whether based in the UK, the EU or elsewhere) will be obliged to disclose inside information under UK MAR and to send notifications to the FCA (*e.g.*, to report dealings by senior managers ("**PDMRs**") and delays in disclosing inside information) and to provide, on request, insider lists. This will be in addition to any obligation under the EU Market Abuse Regulation ("**EU MAR**") to notify an EU competent authority. The FS Bill proposes to implement amendments to UK MAR by clarifying that both issuers and those acting on their behalf or on their account must maintain insider lists and extending the timetable for issuers' disclosure of transactions by PDMRs from within three business days of the transaction to within two business days of being notified by the senior manager.[11] However, there has not been any official reaction from the government or the FCA on the European Securities and Markets Authority's final report on EU MAR.[12] The FS Bill also proposes to increase the maximum criminal sentence for market abuse from seven years' imprisonment to ten years, bringing it in line with comparable economic crimes.

Although the UK's Prospectus Regulation ("**PR**") largely mirrors the EU PR, FCA-approved prospectuses may no longer be passported into the EU (and vice versa). EU issuers offering securities to the public in the UK, or seeking admission to trading on a UK venue, must have a prospectus approved by the FCA, regardless of whether an EU competent authority has already approved the prospectus. Issuers may therefore be impacted by a duplication of effort and deal costs. Prospectuses passported into the UK before IP Completion Day will remain valid in the UK until they would otherwise expire (12 months after first approved), in accordance with the UK's transitional measures (but any subsequent supplements will not be 'grandfathered' and will require approval by both the FCA and the relevant EU competent authority). In contrast, UK-approved prospectuses passported into the EU before IP Completion Day cannot be used after that date, though an issuer may, in principle, submit an FCA-approved prospectus (provided it complies with the EU PR) to the relevant EU competent authority for its approval for use in the EU. ICMA has published updated standard form selling restrictions and legends relating to the PR, the Packaged Retail and Insurance-based Investment Products Regulation and the Markets in Financial Instruments Directive ("**MiFID**") and other materials for use in debt capital markets transactions.

Following the end of the Brexit transition period, EU banks are subject to the requirements of Article 55 (contractual recognition of bail-in) of the EU Bank Recovery and Resolution Directive ("**BRRD**") in respect of English law governed liabilities. Likewise, UK banks will become subject to the PRA contractual recognition of bail-in rules in respect of liabilities governed by the laws of an EEA member state. However, the UK rules grant relief until March 31, 2022 in respect of EEA-law governed "phase two liabilities (unsecured liabilities that are not debt instruments)". In contrast, relief is not granted in respect of liabilities that are intended to count towards a bank's minimum requirement for own funds and eligible liabilities, as this could undermine its resolvability. Accordingly, from the end of transition period, banks will be required to include the bail-in clause in new or materially amended liabilities, other than phase two liabilities. For its part, the European Banking Authority ("**EBA**") rejected calls to include Brexit as a situation which makes inclusion of the bail-in clause impracticable under Article 55(2) BRRD on the basis that this was outside the scope of its law-drafting mandate. AFME and ICMA have published model clauses for recognition of EU and UK bail-in clauses for liabilities other than debt instruments or liabilities governed by industry standard master agreements. Their intended uses include contracts related to new issues of bonds, bond issuance programmes and ECP issuance programmes. Joining bail-in clause requirements in the EU will be harmonised rules under Article 71a BRRD for contractual clauses in non-EEA law governed "financial contracts" (such as underwriting agreements between issuers of bonds and syndicate banks in the context of a new bond issue) recognising that the contract

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11 This post-Brexit requirement is in line with the corresponding requirement under EU Regulation 2019/2115.

12 See: https://www.esma.europa.eu/sites/default/files/library/esma70-156-2391—^final—^report—^-—^mar—^review.pdf.

may be subject to the exercise of resolution powers by the resolution authority to suspend or restrict the firm's payment or delivery obligations, or to suspend a counterparty's termination or security enforcement rights. Member states may also require that parent undertakings ensure that their third-country financial subsidiaries include, within relevant financial contracts, terms to mandate that they cannot engage in early termination, suspension, modification, netting, the exercise of set-off rights or the enforcement of security interests on those contracts, should the resolution authority apply resolution powers to suspend or restrict obligations at the parent undertaking level. Final draft rules on the mandatory contents of the clause were published by the EBA in December 2020.[13] Once more, English law financial contracts will be within scope. In the UK, the PRA had anticipated the new Article 71a in its original implementation of the BRRD and has not, therefore, amended its existing "Stay in Resolution" rules.[14]

The home/host state distinction under the Transparency Directive has fallen away as between the UK and the EU. UK-incorporated issuers with securities admitted to trading on a UK regulated market will be required to use UK-endorsed IFRS ("**UK IFRS**") or UK GAAP for their accounts for financial years commencing on, or after, IP Completion Date. EU-incorporated issuers with securities admitted to trading on a UK regulated market are also able to use EU-endorsed IFRS ("**EU IFRS**"), as the UK government has determined it to be "equivalent" to UK IFRS. The FCA has published an amended list of third countries it regards as equivalent in relation to provisions of the Disclosure Guidance and Transparency Rules ("**DTR**") 4. The amendment reflects the equivalence decision adopted in relation to EU IFRS—issuers of securities admitted to trading on a UK regulated market with a registered office in a third country, which report their annual and half-yearly consolidated financial statements following EU IFRS, are exempt from DTR 4.1.6R(1) (Audited financial statements) and DTR 4.2.4R(1) (Preparation and content of a condensed set of financial statements).[15] UK issuers with securities admitted to a regulated market in the EU can use UK IFRS for EU prospectuses, provided the notes to the audited financial statements state they comply with EU IFRS. To date, the EU has not indicated whether it will declare UK IFRS equivalent, but this is not expected in the short- to medium-term. Absenting an equivalence declaration, UK issuers of wholesale debt admitted to a regulated market in the EU should include a statement in their prospectuses that their financial information has not been prepared in accordance with EU IFRS, together with a description of the differences between EU IFRS and UK IFRS. As UK IFRS currently mirrors EU IFRS, this is a consideration for issuers to the extent the UK and EU financial standards diverge.

Impact on loans

The on-shoring of EU legislation has resulted in a complex set of statutory instruments and other legislation. For borrowers and issuers, references to EU legislation in existing and new contracts should be reviewed and amended or replaced as appropriate. In November, the Loan Market Association ("**LMA**") produced a Brexit note signalling the changes it intends to make to its syndicated loan documentation post-transition, together with two "destination tables" outlining how certain EU legislative references should be treated in the LMA standard form facility documentation and private placement documentation.[16] Certain technical changes to the Article 55 bail-in clause would also need to be considered by the parties.

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13 See: https://www.eba.europa.eu/sites/default/documents/files/document—^library/Publications/Draft%20Technical%20Standards/2020/RTS/961455/Draft%20RTS%20on%20stay%20powers%20%28art71a—^BRRD%29.pdf.

14 See: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2020/ps2820.pdf?la=en&hash=5B4AC7C4F9F3F67B194A56D0E28FD4D833FDD81F.

15 It also makes certain amendments in relation to the exemption granted in relation to the United States, to clarify that the exemption from DTR 4.1 (Annual financial report) in respect of Section 13(a) of Securities Exchange Act of 1934 and the rules governing financial reporting for issuers of securities in the U.S., does not extend to DTR 4.1.7R(4) (Auditing of financial statements). See: https://www.fca.org.uk/markets/primary-markets/regulatory-disclosures/equivalence-non-uk-regimes.

16 See: https://www.lma.eu.com/brexit/documents.

In accordance with guidance issued by the LMA and the Law Society,[17] parties to cross-border transactions should carefully consider where proceedings would be brought and where any judgment would need to be enforced, post-Brexit. The Recast Brussels Regulation no longer applies in the UK where proceedings are started after IP Completion Day. Unless the UK's application to accede to the Lugano Convention is approved (EU Member States have not yet consented), and provided it is applicable, the 2005 Hague Convention on Choice of Court Agreements (the "**Hague Convention**") will govern issues relating to jurisdiction and the enforcement of judgments as between the UK and EU states (as well as the other signatories to the Hague Convention, namely Singapore, Mexico and Montenegro). Parties should be mindful that the Hague Convention will only apply where: (i) there is an exclusive choice of court agreement (it does not apply to an asymmetric or unilateral jurisdiction clause, where one party must bring proceedings in a designated court but the other party has a choice of where to being proceedings), (ii) the dispute falls within the subject matter scope of the Hague Convention; and (iii) the exclusive choice of court agreement was entered into after the Hague Convention came into force for the country whose courts were chosen. Note also that, unlike the Recast Brussels Regulation, the Hague Convention only applies to final judgments and does not govern the enforcement of interim measures (for example, interim freezing orders granted pending final judgment in proceedings). The enforceability of interim measures in EU courts will therefore depend on the local rules in each jurisdiction. There are conflicting views on whether the Hague Convention will apply to choice of court agreements in favour of UK courts concluded from October 1, 2015 when it entered into force for the UK as an EU member state (the position of the UK), or only from January 1, 2021 when it entered into force for the UK in its own right (the position of the EU Commission). Despite this uncertainty, it is clear that under the Hague Convention EU courts will generally respect exclusive English choice of court agreements which were concluded after IP Completion Day and will enforce the consequent judgments.

Where the Hague Convention does not apply, the UK and EU courts will apply their own national rules in relation to jurisdiction and the enforcement of judgments in the absence of any specific treaty between the UK and the relevant jurisdiction. It is worth noting that the English common law rules are a sophisticated and well-tested system of rules which have continued to be applied alongside the EU regime where the EU rules did not apply. However, there may be more opportunities for litigants to mount jurisdictional challenges, including on the grounds of *forum non conveniens* and the risk of litigants attempting to bring parallel proceedings in other EU jurisdictions may increase. That being said, the English court is likely to once again issue anti-suit injunctions to restrain parties from pursuing parallel litigation in the EU in breach of an English jurisdiction agreement, which could prove to be a powerful deterrent.

Frequently asked questions

1. **Should I still use English law as the governing law of loan and facility agreements?**

   English law remains a popular choice for market participants given English law's long history of upholding and respecting parties' commercial bargains. The courts in EU member states will continue to give effect to English law as the parties choice of law. Rome I Regulation, which requires EU member states to give effect to the parties' choice of law, has been retained as domestic law and will continue to apply regardless of whether that law is the law of an EU member state or the law of a third country such as New York law or English law post-Brexit.

[17] See: The Law Society guidance on "End of transition period guidance: choice of court agreements" and "End of transition period guidance: enforcement of foreign judgments."

2. **What about the jurisdiction provisions in the LMA's form of facility documentation?**

   Many of the LMA's recommended forms of English law facility documentation use one-sided exclusive jurisdiction clauses. One of the main reasons for lenders preferring a one-sided exclusive jurisdiction clause is to maximise the lender's ability to take action against the debtor group in any jurisdiction in which the debtor group has assets.

   For the reasons set out above, parties choosing a non-Hague compliant jurisdiction clause (*e.g.*, a one-sided exclusive jurisdiction clause in favour of UK courts) would need to consider whether such a clause would be enforceable under the national rules of the EU member state where enforcement of judgment is sought. Some of the questions that the parties should consider include:

   i. Whether the enforcement of an English judgment in an EU member state is sufficiently important in the context of the transaction (*e.g.*, are there significant assets of the borrower group located in that EU member state?);

   ii. Whether the national rules of the relevant EU member state permit enforceability of an English judgment once the Recast Brussels Regulation no longer applies to English judgments; and

   iii. If the answer to the second question is in the negative or uncertain, whether a two-way exclusive jurisdiction clause or an arbitration clause should be used instead.

The LMA has introduced an optional two-way exclusive jurisdiction clause pursuant to the Hague Convention for use where the parties consider such a jurisdiction clause to be appropriate for their transaction.

LIBOR Transition: The Road So Far and Frequently Asked Questions

Despite the disruption caused by COVID-19 (and the clamour of Brexit), the UK authorities have repeatedly emphasised that no one should assume that LIBOR will continue to exist after 2021. Notably, as regards sterling LIBOR, the top-level priorities of the Working Group on Sterling Risk-Free Reference Rates (the "**SRFR Working Group**") include that markets and their users are fully prepared for the end of sterling LIBOR by the end of 2021. In particular the SRFR Working Group has recommended that, from the end of March 2021, sterling LIBOR is no longer used in any new lending or other cash products that mature after the end of 2021. Throughout the remainder of the year, existing contracts linked to sterling LIBOR should be actively transitioned where possible.[18]

The authorities have acknowledged that certain "tough legacy" contracts—existing LIBOR-linked contracts that have no or inadequate fallbacks and no realistic ability to be amended prior to LIBOR's cessation—required additional measures to facilitate their transition to a non-LIBOR rate. Accordingly, the UK government proposed amendments to the UK BMR, via the FS Bill, to grant the FCA additional powers to manage an orderly wind-down of a "critical benchmark," such as LIBOR. The new powers will extend the circumstances under which the FCA may require an administrator to change the methodology used to calculate such a benchmark if doing so will protect consumers or ensure market integrity. These powers will be available in the event that the FCA makes an announcement that the relevant benchmark is no longer representative and will not be restored to representativeness. In such circumstances, use of that benchmark must cease. However, the FCA will have the power to permit continued use, including in legacy contracts, where it considers this to be appropriate. The UK government's proposals are based on a solution proposed by the SRFR Working Group for LIBOR to be stabilised via a "synthetic methodology" as a means of managing the wind-down of LIBOR. The replacement methodology has not yet been determined and the FCA has recently consulted on possible methodology changes.[19] The FCA indicated that it does not envisage compelling continuation on a synthetic basis for euro or Swiss franc LIBOR. Conversely, the FCA stated that this course of action appeared appropriate for the more commonly used sterling settings, and that it would continue to assess whether this might also be the case for more commonly used yen and U.S. dollar settings.

In July 2020, the European Commission published a proposal for a regulation amending the EU Benchmarks Regulation regarding the designation of replacement benchmarks for certain benchmarks in cessation, including LIBOR. Under the proposal, a statutory replacement rate designated by the Commission would take the place of LIBOR in financial instruments, financial contracts and measurements of the performance of an investment fund which involve an EU 'supervised entity,' and which do not include

[18] See: https://www.bankofengland.co.uk/news/2021/january/the-final-countdown-completing-sterling-libor-transition-by-end-2021.

[19] See: https://www.fca.org.uk/news/statements/fca-consults-on-new-benchmark-powers.

a suitable fallback mechanism. The Commission intended to adopt a recommendation encouraging EU member states to select the replacement rate chosen for EU-supervised entities as the statutory replacement rate in their national statutes. The Commission's proposal has been further developed in the legislative process, with political agreement being reached in December 2020. A consolidated version of the text agreed between the Council of the European Union and the European Parliament, dated December 8, 2020, extends the scope of the proposal to any "contract" or MiFID financial instrument that is governed by the law of a member state and references the relevant benchmark and any contract that is subject to the law of a third country but the parties to which are all established in the EU and where the law of that third country does not provide for an orderly wind-down of a benchmark.[20] In addition, a framework for the replacement of a benchmark by national legislation in certain circumstances is provided for.[21]

In turn, industry bodies published a number of guidance notes and model documents to help companies manage the transition from LIBOR. The LMA published further model documentation relating to LIBOR transition in syndicated loan documentation including: (i) Risk-Free Reference Rate terms and a model replacement of screen rate clause; (ii) a term sheet for multicurrency term and revolving facilities agreements incorporating rate switch provisions; (iii) an exposure draft multicurrency term and revolving facilities agreement incorporating rate switch provisions and (iv) a model rate switch agreement.

In October 2020, the International Swaps and Derivatives Association published the 'IBOR Fallbacks Supplement' and 'IBOR Fallbacks Protocol,' providing guidance on incorporating robust fallbacks for derivatives linked to certain interbank offered rates ("**IBORs**"), with the changes having come into effect on January 25, 2021. Such fallback mechanisms in the relevant currency would apply following a permanent cessation of the IBOR in that currency. For derivatives referencing LIBOR, these would also apply following a determination by the FCA that LIBOR in that currency is no longer representative. In each case, the fallbacks will be adjusted versions of the risk-free rates identified in each currency. As set out in its consultation, the synthetic methodology tabled by the FCA is also based on the risk-free rates, combined with a fixed spread that is identical to the spread in the ISDA protocol fallbacks.

The Alternative Reference Rates Committee ("**ARRC**") published the New York state legislative proposal in March 2020 to facilitate transition from U.S. dollar LIBOR ("**USD LIBOR**") to its recommended alternative, the Secured Overnight Financing Rate ("**SOFR**"). The proposed legislation would apply only to USD LIBOR contracts governed by New York law, in the event of statutory trigger events, including a permanent cessation of LIBOR, or the occurrence of a pre-cessation trigger event related to LIBOR. Contracts that are silent or without adequate fallback language to address the cessation of LIBOR will automatically transition to the recommended benchmark replacement ("**RBR**") under the proposed legislation—likely SOFR, as published by the Federal Reserve Bank of New York, plus a spread adjustment selected by the relevant authority. The proposed legislation would also override fallback language that references a LIBOR-based rate, such as last quoted LIBOR, in favour of the RBR. The planned adoption of this proposal in 2020 was delayed due to COVID-19 but adoption is expected in 2021. In November, the ICE Benchmark Administration ("**IBA**"), as administrator of LIBOR, proposed to stagger cessation of USD LIBOR tenors beyond 2021. While subject to consultation which closed on January 25, 2021, the IBA proposed to cease publication of the lesser utilised one-week and two-month USD LIBOR settings immediately after publication on December 31, 2021, and the remaining (more widely utilised) USD LIBOR settings immediately after publication on June 30, 2023—thereby allowing many legacy contracts to mature before USD LIBOR

[20] See: https://data.consilium.europa.eu/doc/document/ST-13652-2020-ADD-1/en/pdf.

[21] The Council and the Parliament's text also extends the transition period for the use of third-country benchmarks. EU supervised entities will be able to use such benchmarks until the end of 2023. The Commission may further extend this period until the end of 2025 in a delegated act to be adopted by 15 June 2023, if it provides evidence that this is necessary in a report to be presented by that time.

ceases altogether. The timeline for sterling, euro, Swiss franc and yen LIBOR remains unchanged as the IBA's consultation proposed ceasing publication of all LIBOR settings in these currencies at the end of 2021.

FCA Director of Markets and Wholesale Policy, Edwin Schooling Latter, stated, in a speech on January 26, 2021, that the FCA sees "no case for delaying decisions or announcements beyond the time necessary properly to assess the consultation responses that have now been received".[22] In particular, if IBA confirms that following its consultation it intends to cease LIBOR settings, and if the FCA is satisfied that cessation can occur in an orderly fashion and decides not to compel continued production on a synthetic basis of a relevant setting, then the FCA could announce that the settings will cease. It is also possible that the FCA makes a "pre-cessation announcement" (in terms of ISDA documentation) in respect of one or more settings. This would be where it is clear that the relevant panel will end, but the FCA envisages consulting on requiring continued publication on a synthetic basis (or is still assessing whether to do so). Whether a relevant setting is subject to a cessation announcement, a pre-cessation announcement, or both, announcements covering all settings could be made on the same day. As pointed out by Mr Schooling Latter, spread calculations would as a result be fixed on the same day (but not actually applied until after the last date of proposed panel bank publication).

Mr Schooling Latter also signalled certain other important policy developments that are likely in the coming months. Notably, the FCA expects to issue consultation proposals in the spring 2021 on a framework for using powers under the FS Bill to restrict new use of a LIBOR setting where IBA will cease publication and to define which legacy contracts will be allowed to use synthetic LIBOR. The first power is relevant to U.S. dollar LIBOR under IBA's proposals. Even where a U.S. dollar LIBOR setting continues to be published on a representative basis until end-June 2023, there will be restrictions on new use after end-2021.

[22] See: LIBOR – are you ready for life without LIBOR from end-2021? | FCA

The FCA's proposals may allow new use only in defined categories of risk-management transactions used to manage legacy exposure (following the approach of U.S. regulators). As regards "tough legacy" contracts, Mr Schooling Latter described the following cases as falling "unambiguously into the 'tough legacy' bucket": (i) a retail mortgage where the lender must have borrower consent to change, but cannot get the borrower to respond to change proposals; and (ii) a bond where the issuer offers conversion to compounded SONIA plus a credit adjustment spread calculated on the same basis as in ISDA documentation, in line with market consensus on a fair fallback, and the bondholders do not reply or withhold their consent in an effort to push for terms that are out of line with these market standards.

Concerns remain as to whether the different proposals for LIBOR transition outlined by the UK, U.S. and EU regulators will, in practice, work across all relevant jurisdictions, or if the lack of a harmonised solution will result in a conflict of laws (although the amendments made by the EU co-legislators to the EU's draft law may practically reduce the scope for conflict).[23] For example, it is uncertain whether English courts will be obliged to recognise the Commission's statutory replacement rate in English-law governed contracts, and, in respect of New York law governed contracts featuring USD LIBOR, the RBR may apply as a matter of New York law, despite the fact that LIBOR could continue to exist if the FCA has used its powers to direct a change of methodology (that is different to its current plans).

Frequently asked questions

1. **How have parties to new LIBOR loans addressed LIBOR's discontinuation in their documentation?**

   The standard interest rate fallback provisions in an LMA form loan agreement default to cost of funds if the screen rate is unavailable. Given that the standard LMA fallback provisions are intended to be

[23] See our article published in Financier Worldwide, Transitioning 'tough legacy' LIBOR contracts – different strokes for different folks?

a temporary measure and are not meant to be a long-term solution to the discontinuation of LIBOR, parties to new LIBOR loans have adopted (broadly) one of the following three approaches:

i. **Agreed process for renegotiation**: If a trigger event occurs, then the parties will rely on a prescribed amendment process to change the pricing terms of the loan. For example, the LMA's "Replacement of Screen Rate" clause provides that on a "Screen Rate Replacement Event" amendments to the facility agreement could be made with the consent of Majority Lenders, rather than all lenders. In August 2020, this has been expanded to include an agreed process for renegotiation which imposes an obligation on the parties to renegotiate in good faith the relevant pricing terms if LIBOR continues to be used to calculate the interest rate on the facility agreement at a specified date before the end of 2021.

ii. **Pre-agreed conversion terms**: Such loans include a hard-wired switch mechanism to flip from LIBOR to an economically-equivalent RFR-based rate at a specified date prior to the end of 2021 or if a specified trigger event occurs. There have been various high-profile deals adopting this mechanism such as the Royal Dutch Shell's 2019 USD-syndicated revolving credit facility. The LMA rate switch documentation exposure drafts published in November 2020 adopt this methodology. Under the form of the agreement, interest is initially linked to an existing forward-looking term rate (*e.g.*, sterling LIBOR). On a pre-agreed date falling before December 31, 2021, or if a specified trigger event occurs, the interest rate switches to the pre-agreed alternative rate calculated on a compounded basis (*e.g.*, compounded SONIA for sterling).

iii. **Pre-agreed fallback terms**: This is similar to the hard-wired switch approach, but the trigger is the discontinuation or unavailability of LIBOR instead of an automatic switch on a specified date. This is the approach recommended by ARRC for new U.S. dollar LIBOR transactions. While this has been included in various bond and derivative transactions, there has been limited take-up of ARRC's recommended language in the European loan markets given the prevalence of LMA-style facility agreements. It is expected that as we progress into 2021, we will see more European loans incorporating the pre-agreed conversion terms in the form of the LMA exposure drafts.

2. **If I would like to use a hard-wired approach, how are risk free rates used to calculate interest for loans?**

Loan products that have used LIBOR previously are likely to switch to using the applicable risk-free reference rate (*e.g.*, SONIA for Sterling LIBOR and SOFR for USD LIBOR) as compounded in arrears with a look-back period, which is usually set at five business days, plus a credit adjustment spread. Breaking this into its component parts:

i. Compounding, in this sense, means the RFR is compounded using the daily published rate; it does not mean "capitalisation" of the interest.

ii. The look-back period is included in order for the parties to determine the RFR over an observation period, which is shifted five business days ahead of the interest period, so that the parties can ascertain what the interest amount is due a few days prior to the actual payment date, which is likely to coincide with the last day of the interest period.

iii. LIBOR is typically higher than the corresponding RFRs since LIBOR, being the wholesale funding rate of the panel banks, has embedded within itself the risk premium to take into account the credit risk of the banks as well as a term premium to take into account liquidity and inflation risks over a longer time horizon. A credit adjustment spread is added to the replacement rate to make it economically equivalent to the IBOR being used and to address the issue of potential transfer of economic value from one party to another as a result of the rate switch.

The LMA exposure drafts adopt this basic framework, although there are different approaches on the specific details of the methodology. For example, there are two approaches to calculating compounded RFRs, namely with or without "observation shift." In simple terms, such difference in methodology affects the weighting of daily RFRs over non-business days on which RFRs are not published. While such difference in approach is unlikely to produce significantly different results absent extreme volatility in the RFRs over the calculation period, the difference will nonetheless affect how the amount is calculated. In the earlier RFR-based English law credit agreements, such determination was made "without" the observation shift (also known as the "lag" method) before the "observation shift" method gained more prominence. However, more recently, the "lag" method is making a comeback given that it is perceived by market participants to be more suited to deal with intra-interest period events such as early prepayments or loan trading.

Environmental, Social and Governance Developments

The global trend towards environmental, social and governance (“**ESG**”) related investments has steadily increased in recent years and, during the maelstrom of 2020, capital flows into funds incorporating sustainability and ESG-driven strategies hit an all-time high. Institutional investors have become increasingly vocal in respect of their sustainability and ESG priorities, and ESG has become an important topic of shareholder engagement.[24] The market for green bonds, in particular, has expanded and diversified in recent years with increased investor demand, including from asset managers, insurers and pension funds. During the pandemic, sovereign green bond issuances continued with a number of tap issuances and a few debut issuances including by Germany and Sweden.

Global regulatory reform in this area also strengthened further in 2020 with the announcement of the EU’s “Green Deal” which makes new funds available, proposes new legislation and seeks to prioritize climate goals in EU policy-making.[25] The European Central Bank also declared that bonds with coupon structures linked to certain sustainability performance targets will become eligible (from January 1, 2021) as collateral for Eurosystem purposes, provided they comply with the eligibility criteria. Although less prevalent than green bonds, social bonds gained momentum during COVID-19 as social issues came to the fore during the crisis, sparking investor demand. Several large issuances of social bonds came to market, issued by supranational issuers (such as the International Finance Corporation and the African Development Bank), corporates and banks (such as Bank of America and Caixabank) alike. Recognising market appetite, ICMA published updated voluntary guidelines for issuances of social bonds (the ‘Social Bond Principles’), to improve standardisation and encourage issuers to adhere to principles for reporting and transparency through the life of the bond.[26] There has also been an uptick in sustainability-linked credit facilities, which allocate loan proceeds to eligible green projects or sustainability targets.

Detailed plans in respect of the UK government’s commitment to match the “ambition of the objectives of the EU’s Sustainable Finance Action Plan” under its own Green Finance Strategy have begun to emerge, including the planned development of a UK green taxonomy. The FCA launched a consultation in March 2020 on its proposal to introduce a new continuing obligation in the Listing Rules that would require commercial companies with a premium listing in the UK to make climate-related disclosures in line with the framework established by the Taskforce on Climate-related Financial Disclosure (the “**TCFD**”), on a “comply or explain” basis (the same approach as the UK Corporate Governance Code). The FCA also consulted on a technical note that clarifies its expectations in relation to the existing ESG-related disclosure obligations under the Listing Rules and Disclosure

[24] See our alert memorandum: Increased ESG Focus Shows No Signs of Slowing Down in 2021.

[25] See our alert memorandum: A Sustainable Recovery for Europe: The EU’s Green Deal.

[26] See our alert memorandum: Social Bonds in Response to the COVID-19 Crisis: a Guide for Issuers.

Guidance and Transparency Rules and under the EU's Prospectus Regulation and Market Abuse Regulation. In November, the FCA confirmed that this new continuing obligation will come into effect for reporting periods from January 1, 2021 onwards. A policy statement and the final rules were published in December 2020. HM Treasury also announced in November its intention to make TCFD-aligned disclosures mandatory across the economy by 2025, with a significant portion of mandatory requirements in place by 2023. The UK Joint Government-Regulator Taskforce's Interim Report and accompanying roadmap was published, indicating how it proposes to achieve this aim.

Significant challenges remain in the context of ESG investments and reporting. For financial firms and investors these include, respectively, how to accurately collect, measure and share ESG information on credit exposures and investments and how to fairly compare companies that report under disparate and/or competing ESG standards.[27] In turn, issuers are faced with the challenge of navigating and complying with a plethora of ESG reporting standards. Efforts to harmonise the various taxonomies and frameworks in the field of sustainable finance gathered pace during 2020, most significantly with the Taxonomy Regulation.[28] Notably, in September, the International Organization of Securities Commission launched a task force to harmonise standards, and the International Business Council of the World Economic Forum (in collaboration with the Big Four accountancy firms) released a set of universal ESG metrics and disclosures to measure stakeholder capitalism.

[27] See our alert memorandum: Sustainable Finance: A Global Overview of ESG Regulatory Developments.

[28] See our alert memorandum: A Framework Taxonomy for Sustainable Finance.

Sanctions Developments

On July 6, 2020 the UK government announced the introduction of a "Global Human Rights" sanctions regime (the "**GHR Sanctions**")—the first time the UK has imposed sanctions measures independently from the European Union and the first time it has imposed sanctions directly in response to human rights violations.[29]

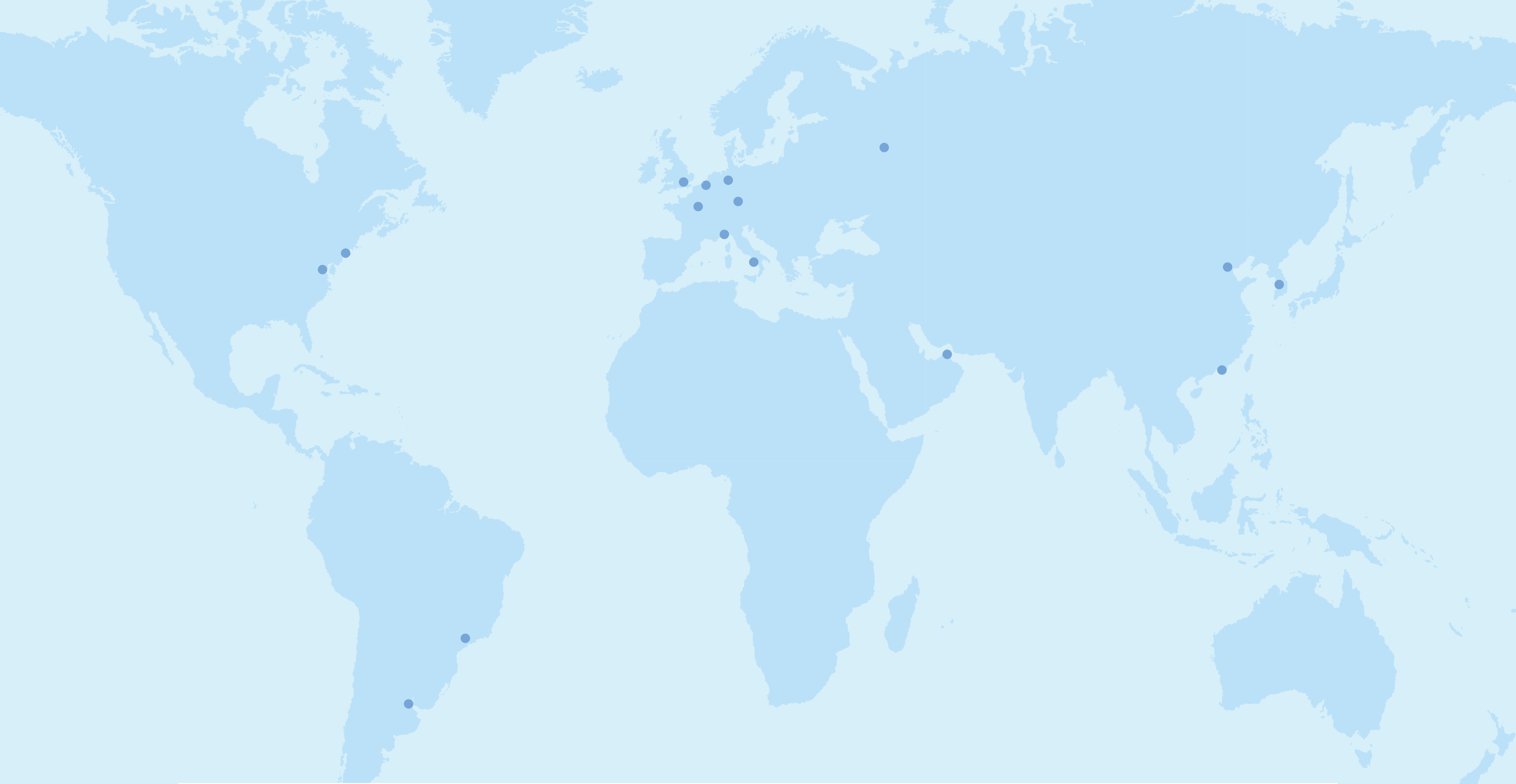
Under the GHR Sanctions, it is prohibited for persons in the UK, and UK nationals and entities located overseas, to: (i) deal with funds or economic resources owned, held or controlled by a designated person; or (ii) make funds or economic resources available to or for the benefit for a designated person. The designated persons are also prohibited from entering the United Kingdom. The asset freeze also applies to any entity "owned or controlled" by a designated person. The measures are similar to existing EU sanctions with effect in the United Kingdom; however, there may be divergence on points of detail and interpretation.

On June 30, 2020, the Court of Appeal confirmed in *Lamesa Investments Limited v Cynergy Bank Limited* [2020] EWCA Civ 821 that a borrower under a facility agreement was excused from making payments because of the risk of U.S. secondary sanctions. This case offers rare guidance from a national court in relation to the impact of the risk of U.S. secondary sanctions on contractual performance. In this instance, the court clarified that whether or not non-performance may be excused will depend on the specific words of the affected contract and the wider context. This was later reiterated in *Banco San Juan Internacional Inc v Petroleos De Venezuela SA* [2020] EWHC 2937, wherein the Commercial Court rejected all of the arguments put forward by Petroleos De Venezuela SA as to why it was prevented from making repayments as a result of the imposition of U.S. sanctions. In this case, the court rejected the argument that the Court of Appeal's decision in *Lamesa v Cynergy* demonstrated that it is normal course in commercial agreements to suspend payment obligations where payment would otherwise be in breach of U.S. sanctions.

Both cases emphasise the importance of the contractual construction of the particular wording of the sanctions clause and demonstrate the complexity of determining the extent to which the risk of sanctions may excuse non-performance of a party's obligations. It is likely that the courts will continue to grapple with these questions in future years.[30]

29 See our alert memorandum: New UK Sanctions Regime Introduced.

30 See our alert memorandum: UK Court of Appeal Says Risk of U.S. Secondary Sanctions is a "Mandatory Provision of Law" Excusing Non-Payment.



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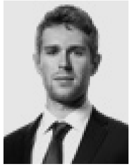

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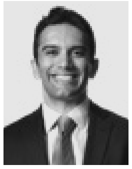

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