ALERT MEMORANDUM

FCA Ushers In The End Of LIBOR

March 10, 2021

On March 5, 2021, the UK Financial Conduct Authority ("FCA") announced the dates that panel bank submissions for all London interbank offered rates ("LIBOR") settings will cease, after which representative LIBOR rates will no longer be available.

After December 31, 2021, the FCA will no longer require panel banks to submit quotes for LIBOR settings other than overnight and 12-month U.S. dollar LIBOR and, after June 30, 2023, the FCA will no longer require panel banks to submit quotes for any U.S. dollar LIBOR settings.[1]

Based on undertakings received from the panel banks, the FCA does not expect that any LIBOR settings will become unrepresentative before the aforementioned dates. The FCA will consult on whether it should require LIBOR's administrator, ICE Benchmark Administration ("IBA") to publish certain "synthetic" rates (*i.e.,* a forward-looking term rate version of the designated alternative risk-free rate for the relevant LIBOR currency plus an adjustment spread), for use in "tough legacy" contracts.

The FCA announcement effectively triggers certain LIBOR "fallback" mechanisms, including those set forth in the recent protocol released by the International Swaps and Derivatives Association, Inc. ("ISDA"), underscoring the need for companies to complete their LIBOR transition plans.[2]

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

LONDON

Jim Ho
+44 20 7614 2284
jho@cgsh.com

Colin D. Lloyd
+1 212 225 2809
clloyd@cgsh.com

Ferdisha Snagg
+44 20 7614 2251
fsnagg@cgsh.com

Brandon M. Hammer
+1 212 225 2635
bhammer@cgsh.com

Jonathan Griggs
+44 20 7614 2312
jgriggs@cgsh.com

Bree Morgan-Davies
+44 20 7614 2223
bmorgan-davies@cgsh.com

[1] According to the FCA's announcement, publication of the following 26 LIBOR settings will permanently cease (*i.e.,* there will be no synthetic rates) after the following dates: (A) after December 31, 2021, in the case of: (i) the overnight, one-week, two-month and 12-month sterling LIBOR settings; (ii) all seven euro LIBOR settings; (iii) all seven Swiss franc LIBOR settings; (iv) the Spot Next, one-week, two-month and 12-month Japanese yen LIBOR settings; and (v) the one-week and two-month U.S. dollar LIBOR settings; and (B) after June 30, 2023, in the case of the overnight and 12-month U.S. dollar LIBOR settings. Continued publication of the remaining nine LIBOR settings in synthetic form is subject to FCA consultation (see Part II. below).

[2] *See*: https://www.fca.org.uk/news/press-releases/announcements-end-libor

I. Impact on Derivatives Contracts

ISDA has confirmed that the FCA's announcement constitutes an "Index Cessation Event" under the ISDA Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings.[3] As such, the fallback spread adjustments (published by Bloomberg) to be used in ISDA IBOR fallbacks have been fixed as of the date of the FCA's announcement (*i.e.*, March 5, 2021) for all euro, sterling, Swiss franc, U.S. dollar and Japanese yen LIBOR settings.[4] This provides welcome clarity on the future terms of the large number of derivatives contracts which now incorporate the ISDA fallbacks.

The ISDA fallbacks (*i.e.,* to the adjusted risk-free rate plus an adjustment spread) will automatically occur for outstanding derivatives contracts that incorporate the IBOR Fallbacks Supplement or are subject to adherence of the ISDA 2020 IBOR Fallbacks Protocol on the following dates (the "Index Cessation Effective Date"):

- the first London Banking Day on or after January 1, 2022 (being the first date immediately after December 31, 2021): for outstanding derivatives referenced to all euro, sterling, Swiss franc and yen LIBOR settings; and
- the first London Banking Day on or after July 1, 2023 (being the first date immediately after June 30, 2023): for outstanding derivatives referenced to all U.S. dollar LIBOR settings. Under the fallbacks methodology, even though the rate for the one-week and two-month U.S. dollar LIBOR will be discontinued after December 31, 2021, their settings will continue to be computed using linear interpolation between December 31, 2021 and June 30, 2023 because a longer tenor and a shorter tenor of U.S. dollar LIBOR will continue to be provided in that period, before falling back to the adjusted risk-free rate plus spread after June 30, 2023.

The applicable Index Cessation Effective Dates set out above are not fixed and may change as a result of future events, such as in the event the FCA makes a later announcement that the relevant LIBOR settings cease to be published or become "non-representative" as of a different date than originally contemplated. As noted above, however, the FCA does not anticipate making any such announcement before the Index Cessation Effective Dates, based on undertakings received from the panel banks.

II. Consultations on synthetic LIBOR

From Q2 2021, the FCA will consult on whether it should require IBA to continue to publish the following nine LIBOR settings on the basis of a changed (*i.e.,* "synthetic") methodology, using the new powers the UK government has proposed granting the FCA under the onshored Benchmarks Regulation ("UK BMR"):

- the remaining one-month, three-month and six-month sterling LIBOR settings, for a further period after December 31, 2021;
- the remaining one-month, three-month and six-month Japanese yen LIBOR settings, for an additional one year only after December 31, 2021 (*i.e.,* such that publication of these settings will permanently cease following publication on December 30, 2022); and
- the remaining one-month, three-month and six-month U.S. dollar LIBOR settings, for a further period after June 30, 2023, taking into account feedback from

[3] *See*: https://www.isda.org/2021/03/05/isda-statement-on-uk-fca-libor-announcement

[4] The spread adjustments are available at https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf.

the U.S. authorities and other stakeholders.[5]

In the event that the FCA requires IBA to continue to publish such LIBOR settings on a synthetic basis, the synthetic rate will be a forward-looking term rate version of the relevant risk-free rate plus a fixed spread adjustment calculated over the same period and in the same way as the spread adjustment implemented in the IBOR Fallbacks Supplement and the 2020 IBOR Fallbacks Protocol.

It should be noted that any synthetic LIBOR will no longer be "representative" for purposes of the UK BMR, and is not for use in new contracts. Any synthetic rates will only be used in "genuine tough legacy contracts"[6] – those that it is not practicable to convert before publication of a representative LIBOR ceases – in order to limit any disruption caused by LIBOR's discontinuation and the risk of any litigation which may arise in the context of such contracts and the FCA's exercise of its new powers. HM Treasury has also launched a consultation on a possible legal safe harbour for parties affected by the wind-down of critical benchmarks, such as LIBOR, pursuant to the UK BMR.[7]

The exercise of the FCA's new powers to require continued publication of LIBOR settings on a synthetic basis is subject to enactment of the Financial Services Bill ("FS Bill") by the UK Parliament, and subject to consultation by the FCA in due course. The FS Bill also proposes to give the FCA power to define which legacy contracts will be allowed to use synthetic LIBOR to help an orderly wind down (pursuant to new Article 23C of UK BMR).[8] The FCA will also consult on its proposed power to restrict use of a critical benchmark when it becomes clear that the administrator will no longer produce a representative benchmark rate (pursuant to new Article 21A of the UK BMR).[9]

III. Impact on other contracts linked to U.S. dollar LIBOR

On March 8, 2021, the U.S. Alternative Reference Rates Committee ("ARRC") confirmed that the announcements on March 5, 2021 regarding the future cessation and loss of representativeness of LIBOR benchmarks constitutes a "Benchmark Transition Event" with respect to all U.S. dollar LIBOR settings under the ARRC-recommended fallback language for issuances or originations of LIBOR floating rate notes, securitisations, syndicated business loans, and bilateral business loans.[10]

The occurrence of a Benchmark Transition Event does not require immediate transition under the ARRC recommended fallback language, which is triggered on the "Benchmark Replacement Date" instead. The Benchmark Replacement Date is expected to occur on or immediately after the cessation date for the relevant U.S. dollar LIBOR setting, pursuant to the announcements (*i.e.*, December 31, 2021 for one- week and two-month U.S. dollar LIBOR; and June 30, 2023 for

[5] *See*: https://www.fca.org.uk/markets/transition-libor/benchmarks-regulation-new-powers-policy-decision-making

[6] *See:* Speech by Edwin Schooling Latter on January 26, 2021: https://www.fca.org.uk/news/speeches/libor-are-you-ready-life-without-libor-end-2021

[7] *See*: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/961317/HMT_Safe_harbour_Consultation.pdf

[8] The FCA intends to consult on the use of this power but has previously indicated that bonds "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 don't reply or withhold their consent in an effort to push for terms that are out of line with these market standards" are an example of contracts which "fall unambiguously into the 'tough legacy' bucket". *See*: Speech by Edwin Schooling Latter on January 26, 2021 (Footnote 6).

[9] *See*: Footnote 5.

[10] *See*: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Benchmark_Transition_Event_Statement.pdf

overnight, one-month, three-month, six-month, and 12-month U.S. dollar LIBOR).[11]

When the fallback rates apply, the fallbacks for non-consumer cash products that incorporate the ARRC-recommended fallback language will apply the same (fixed as of March 5, 2021) spread adjustment values to the recommended fallback rates.

A further Benchmark Transition Event may also occur after June 30, 2023, in the event that: (i) the FCA does require IBA to continue to publish certain U.S. dollar LIBOR settings on a synthetic basis for a period of time; and (ii) the FCA releases a statement at such time confirming its position that such synthetic rates are no longer representative.

IV. Obligations under UK EMIR and UK SFTR

The FCA has also confirmed that amending a reference rate or including a fallback would not trigger the application of margin or clearing requirements under the onshored Regulation on OTC derivative transactions, central counterparties and trade repositories ("UK EMIR"), where this amendment relates to the treatment of legacy LIBOR trades.[12]

Under Article 9 of UK EMIR, counterparties and central counterparties are required to report any modification of a derivative contract to a registered or recognised trade repository no later than the working day following the modification of the contract. Accordingly, if the terms of a derivatives contract state that an alternative rate applies in the place of LIBOR (either immediately or at some future date), this is a reportable modification under UK EMIR and must be reported at the time that the alternative rate takes effect.

This applies to all agreed terms that result in an alternative rate applying in place of LIBOR, including fallbacks agreed on a bespoke basis and fallbacks that take effect as a result of ISDA's 2020 IBOR Fallbacks documentation.

Under Article 4 of the onshored Regulation on reporting and transparency of securities financing transactions ("UK SFTR"), counterparties to securities financing transactions ("SFTs") are also required to report any modification of an SFT to a registered or recognised trade repository no later than the working day following the modification of the transaction.[13]

If the terms of a SFT state that an alternative rate applies in the place of LIBOR (again, either immediately or at some future date), this is reportable under UK SFTR and must be reported at the time that the alternative rate takes effect. Similarly, this applies to all agreed terms that result in an alternative rate applying in place of LIBOR.

V. Obligations under U.S. Swaps Regulations

The U.S. regulators have similarly provided relief from various U.S. swaps regulations that might otherwise apply as a consequence of amending a swap transaction to incorporate the ISDA fallback rates or otherwise address LIBOR cessation. Specifically, the staff of the U.S. Commodity Futures Trading Commission (the "CFTC") has issued no-action relief, stating that amending a swap transaction solely to incorporate the ISDA fallbacks, whether pursuant to the ISDA protocol or a bilateral agreement, or adopting a similar qualifying amendment will not affect the legacy status of the transaction for

[11] *See*: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Benchmark_Transition_Event_FAQs.pdf

[12] *See*: https://www.fca.org.uk/firms/uk-emir/news This mirrors Article 13a of EU EMIR, introduced by the EU Regulation on a framework for the recovery and resolution of central counterparties: *See also*: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0023&from=EN

[13] *See*: https://www.fca.org.uk/markets/sftr/news

purposes of the CFTC's (i) uncleared swap margin rules, (ii) external business conduct requirements (with limited exceptions), (iii) confirmation requirements, or (iv) swap trading relationship documentation requirements.[14] In addition, the staff has issued no-action relief that such an amendment will not trigger application of the CFTC's trade execution or clearing requirements, so long as it is made prior to December 31, 2021.[15] The staff's no-action relief also seeks to ensure that such amendments do not affect the application of the end-user exemptions from the CFTC's clearing and margin requirements.

The U.S. prudential regulators have similarly issued amendments to their non-cleared swaps margin rules, clarifying that similar amendments will not cause swap or security-based swap transactions to lose their legacy status for purposes of such rules.[16]

…

CLEARY GOTTLIEB

[14] *See*: https://www.cftc.gov/csl/20-23/download.

[15] *See*: https://www.cftc.gov/csl/20-24/download, https://www.cftc.gov/csl/20-25/download.

[16] *See*: https://www.clearygottlieb.com/-/media/files/alert-memos-2020/prudential-regulators-amend-non-cleared-swap-margin-requirements.pdf.