Eyes on IBOR: Issue 8

Final issue - September 2021

Introduction

Welcome to the 8th, and final edition of Eyes on IBOR. It's been some four months since our last news round up. Since the FCA's 5 March **announcement** of LIBOR's official demise, aside from increasingly strident Regulatory exhortations to "get on with it", there is little in the way of transformative news - so we have decided to retire this series of round-ups, and report on new LIBOR news items as and when they occur.

The majority of the derivatives market is breathing a sigh of relief at the relatively high adherence rates of the Fallback Protocol; however, the remaining amendment challenge should not be underestimated. The FCA is inching towards a "synthetic LIBOR" solution for tough legacy contracts, while still leaving the category somewhat undefined.

Meanwhile, the UK September key milestone for legacy transition looks challenging. As usual, the following represents the more interesting (or at least noteworthy) developments.

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Contents

Currency focus

Currency focus: GBP

04th August 2021

The Benchmarks (Provision of Information and Documents) (Amendment) Regulations 2021 (SI 2021/920) (Amending Regulations) were published on legislation.gov.uk, with an explanatory memorandum. The Amending Regulations were made on 3 August 2021 and come into force on 8 August 2021. They amend the Benchmarks (Provision of Information and Documents) Regulations 2021 (SI 2021/812) (Regulations), which make provision in respect of a notice or permission given by the FCA to a benchmark administrator under Articles 22A, 22B, 23A and 23D of the UK Benchmarks Regulation ((EU) 2016/1011) (UK BMR) where the FCA is considering whether to wind down a critical benchmark.

04th August 2021

The IBA published a Feedback Statement on the Consultation on the Potential Cessation of GBP LIBOR ICE Swap Rate and announced that it will cease the publication of GBP LIBOR ICE Swap Rate for all tenors immediately after publication on December 31, 2021.

09th July 2021

The Sterling Working Group published a paper, **GBP LIBOR loan contracts – Timelines and considerations for borrowers**, to help borrowers meet the end Q3 2021 milestone for transitioning legacy sterling LIBOR loans to SONIA.

The paper notes that conversion could be with immediate effect, or via a rate switch mechanism at a specified future date or as a result of a trigger event. The paper cites likely resource constraints and internal governance requirements as reasons for market participants not to delay transition until the end of 2021.

01st July 2021

This date marks the entry into force of Section 2 of the **UK Financial Services Act 2021 (FSA)**. The second of seven "Commencement" phases, the second is primarily notable for the application of the new FCA LIBOR powers
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Sections 8 to 21 and Schedule 5 of the Act amend the retained EU law version of the UK BMR to provide the FCA with additional powers to mitigate the effect of a critical benchmark's demise. Specifically, the FCA now has the power to:

- Designate a benchmark as critical, following a decision that the benchmark's representativeness cannot reasonably be restored and maintained. It may then impose requirements on the benchmark's administrator to change the benchmark's calculation methodology, its rules or the administrative code of conduct.
- Prohibit some or all use of a critical benchmark by supervised entities.
- Increase the period during which the FCA can compel an administrator to publish a critical benchmark from 5 years to 10.
- Extend the transitional period for third country benchmarks under the UK BMR, from 31 December 2022 to 31 December 2025.

In essence, the above gives the FCA wide-ranging and flexible powers to deal with tough legacy contracts which, for various reasons, are recognised as being unamenable to "simple" amendment.

04th June 2021

The Working Group on Sterling Risk-Free Reference Rates published a revised version of its **Best Practice Guide for GBP Loans**. The guide addresses conventions for new sterling SONIA-referencing loans (including refinancing and renewals) and for the transition of legacy GBP LIBOR-referencing loans.

The guide was originally published in February 2021 and subsequently updated in March 2021. The June 2021 update deals with the calculation of SONIA-based cost of carry for the secondary market.

29th April 2021

The Financial Services Bill 2019-21 received **Royal Assent**.. The text of the Financial Services Act 2021(FSA) has been published on legislation.gov.uk. In the context of Benchmark Reform, the FSA:

- Amends the UK Benchmarks Regulation (UK BMR) to provide the FCA with additional powers to manage an orderly wind-down of a critical benchmark i.e. LIBOR.
- Extends the transitional period for third country benchmarks under the UK BMR from 31 December 2022 to 31 December 20223 April 2021.

23rd April 2021

The Sterling Working Group published a **paper** outlining key considerations for counterparties that are preparing for the operation of IBOR fallbacks in

Currency focus: GBP (cont.)

non-cleared sterling LIBOR derivatives. The paper examines a number of themes covering operational aspects of non-cleared sterling LIBOR derivatives, including trade and market infrastructure, risk and accounting processes, and regulatory reporting.

It describes issues that may arise when contractual fallbacks take effect, and suggests further steps that counterparties can take to mitigate risks.

21st April 2021

Tushar Morzaria, Chair of the Sterling Working Group published a **letter** to HMT enquiring as to the UK Govt.'s intentions to introduce safe harbour protections. John Glen, the Economic Secretary to the Treasury, **responded** on the 7 May to the effect that the government will 'get round to it'.

19th April 2021

The Sterling Working Group published a **paper** that supports the transition of GBP LIBOR linked legacy structured products and considers how a sterling structured products market could be designed using compounded in arrears SONIA.

The paper addresses various types of structured products, including on-balance sheet issuances and repackaging transactions (new and legacy).


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Currency focus: EUR

03rd August 2021

The EC published the following for consultation:

- A draft **Implementing Regulation** (Ares (2021) 4932489) on the designation of a statutory replacement for certain settings of Swiss Franc (CHF) LIBOR
- A draft **Implementing Regulation** on the designation of a replacement for the EONIA benchmark, which will be discontinued from 3 January 2022. The designated rate will replace contractual references to EONIA in the EU on 3 January 2022.

Comments were able to be made on both consultations until 31 August 2021.

30th July 2021

EC adopts draft Delegated Act (DA) on supervisory fees for benchmarks administrators which is open for comments until 27 August 2021.

From 1 January 2022, ESMA will have direct supervisory responsibilities over EU critical benchmarks and their administrators, and will be responsible for the recognition and supervision of third-country benchmark administrators. The DA will now undergo a 3 month scrutiny period from the Parliament and Council, which may be extended by another 3 month. ESMA's final report indicated that the scrutiny period should be finalised by year-end with the DA entering into application on 1 January 2022.

29th July 2021

ESMA updated its BMR Q&A to clarify whether EU supervised entities can use benchmarks provided by third country public authorities after the end of the transitional period applicable to 3rd country benchmarks.

The update means that EU entities can continue to use benchmarks provided by third country public authorities where those public authorities meet the definition in article 3(1)(29) of the BMR and comply with the conditions set out in Article 2(2)(b).

27th July 2021

the Euro Working Group published two approved statements recommending:

- €STR First Initiative- that interdealer brokers change RFR swap trading conventions from EONIA to €STR from Monday 18th October, in line

with the CCP transition from EONIA to €STR on that weekend.
- Cross-Currency Swaps Initiative- the recommendation of a common start date of 21st September for a switch of quoting conventions in the interdealer market for USD, GBP, CHF and JPY legs of cross-currency swaps.

08th July 2021

The EC Implementing Regulation (EU) 2021/1122 was published in the OJ. The Implementing Regulation amends the list of critical benchmarks established by the EC Implementing Regulation (EU) 2016/1368 by adding the Norwegian Interbank Offered Rate (NIBOR) and removing the London Interbank Offered Rate (LIBOR).The Implementing Regulation entered into force on 10 July 2021.

24th June 2021

The EC issued a **joint statement** with the EBA, ECB and ESMA, warning all market participants to cease their use of any LIBOR settings. The Regulators recommend the following actions:

- Stop using the 35 LIBOR settings, including USD LIBOR, as a reference rate in new contracts as soon as practicable and in any event by 31 December 2021.
- Limit the use of any LIBOR setting published under a changed methodology (also known as “synthetic” LIBOR) only to contracts that are particularly difficult to amend ahead of LIBOR’s cessation (commonly referred to as “tough legacy”)
- Include robust fallback clauses nominating alternative rates in all contracts referencing LIBOR.

11th May 2021

The Euro Working Group **published** recommendations on EURIBOR fallbacks, covering events that could trigger fallbacks in EURIBOR-linked contracts and the rates that could be used if a fallback is triggered.

The recommendations include an €STR-based EURIBOR fallback rate for specific use cases, including debt securities and securitisations and recommendations for a spread adjustment to be added to the fallback rate.

Currency focus: USD

26th July 2021

The Alternative Reference Rates Committee (ARRC) formally recommended the convention switch recommending inter-dealer brokers change USD linear swap trading from USD LIBOR to the Secured Overnight Financing Rate (SOFR).

23rd July 2021

The ARRC announced conventions and use cases for how best to employ the Secured Overnight Financing Rate term rates to successfully transition away from US dollar Libor.

ARRC Chairman Tom Wipf says that when the "SOFR First swaps convention switches on July 26 and the ARRC formally recommends the SOFR Term Rates, market participants should have what they need to use SOFR in all its forms across financial markets, including the use of the SOFR Term Rates for business loans."

11th May 2021

The ARRC released the **Guide to Published SOFR Averages** in order to provide market participants – and nonfinancial corporates in particular – with key information on the LIBOR transition.

The guide shows, amongst other things, how the published Secured Overnight Finance Rate (SOFR) Averages can be used today and what factors market participants should consider before selecting the alternative rate that they use.

21st April 2021

The ARRC **announced** three key principles that will guide its recommendation for a SOFR term rate. The rate must:

- Meet the ARRC's criteria for alternative reference rates, similar to SOFR itself.
- Be rooted in a robust and sustainable base of derivatives transactions over time.
- Have a limited scope of use, to avoid volumes disproportionate to underlying SOFR.

06 April 2021

Governor Cuomo signed **New York Senate Bill 297B/Assembly Bill 164B** into law. The bill is designed to provide legal certainty regarding the LIBOR cessation, by clarifying that:

- The recommended benchmark

replacement rate, a benchmark replacement based on SOFR is a commercially reasonable substitute for LIBOR.

- The discontinuation of LIBOR or the use of a replacement rate does not constitute legal grounds for parties to refuse to perform contractual obligations or declare a breach of contract.

The bill defines the LIBOR replacement date, as the later of:

- The date of the public statement or publication of information announcing that LIBOR will cease to be provided or is no longer representative
- The actual date on which the administrator of LIBOR ceases to provide LIBOR.

The bill goes on to define "recommended benchmark replacement" as a benchmark replacement based on SOFR, which includes any recommended spread adjustment and any benchmark replacement selected by a relevant recommending body, such as the FRB or ARRC.

The bill is intended to ensure business continuity by the provision of a safe harbour from litigation by clarifying that the LIBOR cessation will not:

- Affect or impair any person's right to receive payment under any contract or affect the amount or timing of such payment.
- Discharge or excuse performance under a contract.
- Give any person the right to unilaterally terminate or suspend contractual performance.
- Constitute a breach of contract.
- Void or nullify a contract.

Currency focus: APAC

SGD

31st March 2021

Singapore announced a revised timeline for transition to SORA. The SC-STS Steering Committee has set a deadline of end-September 2021 to cease issuance of SOR derivatives and SIBOR-linked financial products. An exception applies where SOR is used for risk management and transition of legacy SOR positions to SORA. The following deadlines are unchanged:

- 6-month SIBOR will be discontinued by March 2022.
- SOR will be discontinued in mid-2023
- Fallback Rate (SOR) will be published until end-2024.
- 1-month and 3-month SIBOR benchmarks will be discontinued by end-2024.

HKD

25th March 2021

The HKMA issued an update extending new LIBOR –referencing product issuance until year-end 2021, instead of the original earlier end-June 2021 deadline. The extension is in response to market concern over the current unavailability of APAC RFRs and that the premature restriction of LIBOR-linked issuance may result in market fragmentation.


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Regulatory initiatives

21st July 2021

The FCA and BoE published a joint **press release** encouraging liquidity providers in the LIBOR cross-currency swaps market to adopt new quoting conventions for interdealer trading based on RFRs instead of LIBOR from 21 September 2021.

This date is a **key milestone** as set out in the BoE's March 2021 **Dear CEO** letter, from which firms are expected to cease initiation of cross-currency derivatives with a a LIBOR-linked GBP leg expiring after 2021.

13th July 2021

The CFTC's Market Risk Advisory Committee (MRAC) formally recommended a series of 'SOFR First' initiatives in US dollar markets, beginning with interdealer swap markets on 26 July.

The MRAC recommendation also includes a subsequent step to replace use of LIBOR with RFRs in cross-currency swaps, identifying a potential date of 21 September 2021. Timing is yet to be announced in respect exchange traded derivatives and non-linear products.

06th July 2021

the FSB published a LIBOR transition progress report, highlighting:

- The urgency of transition now cessation dates are confirmed
- The continuation of some key US dollar LIBOR tenors through to 30 June 2023 is intended only to allow legacy contracts to mature, not to enable new US dollar LIBOR activity
- Supervisory authorities must increase awareness of the scope and urgency of relevant LIBOR transitions for all other market participants
- Financial institutions and non-financial institutions need to accelerate adoption of RFRs in new contracts, and conversion of legacy LIBOR-referencing contracts to directly reference RFRs or incorporate robust fallback language
- Market participants must not wait for additional tools to transition away from LIBOR to be developed. New rates need to be compatible with financial stability
- Collaboration and co-ordination remain crucial in expediting the transition progress. The FSB encourages authorities to set globally consistent expectations and milestones to rapidly cease

the LIBOR use, irrespective of trade location or currency

05th July 2021

In a **speech** entitled “Six months to go” Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA warned that the FCA does not want to see transition to new so-called credit sensitive rates.

24th June 2021

The FCA **published** a consultation on its proposal to use new powers under the Financial Services Act 2021. The FCA proposes to require the administrator of LIBOR (IBA) to change the way 1-month, 3-month and 6-month sterling and Japanese yen LIBOR settings are determined after 2021 to secure an orderly wind-down.

This will potentially enable the use of a “synthetic LIBOR” in order to deal with tough legacy contracts.

16th June 2021

The FCA and the BoE **announced** that participants in the interdealer USD LIBOR interest rate swap market should transition interdealer trading conventions for USD IRS rate swaps to SOFR from 26 July 2021.

02nd June 2021

The FSB published a statement supporting the potential benefits of using the ISDA historical five-year median spread adjustment for cash products that are to fall back or move from an IBOR to overnight RFRs or to RFR-based term rate

02nd June 2021

the FSB published a statement referencing guidance issued by US banking supervisors in November 2020 and March 2021. These noted that, while the mid-2023 end dates would allow most US dollar LIBOR-linked legacy contracts to roll off, "...entering into new contracts that use USD LIBOR as a reference rate after December 31, 2021 would create safety and soundness risks..." and encouraged firms to "cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021”

Regulatory initiatives (cont)

13th May 2021

The FCA and the BoE published a **joint statement** announcing that they support and encourage liquidity providers in the sterling exchange traded derivatives market to switch the default traded instrument to SONIA instead of LIBOR from 17 June 2021.

29th March 2021

The FCA and the BoE published a **joint statement** announcing that they encourage liquidity providers in the sterling non-linear derivatives market to adopt new quoting conventions for inter-dealer trading based on SONIA instead of LIBOR from 11 May 2021.

Industry initiatives

19th August 2021

ISDA launched the 2021 ISDA EONIA Collateral Agreement Fallbacks Protocol. The 2021 ISDA EONIA Collateral Agreement Fallbacks Protocol offers market participants an efficient way to amend the terms of certain ISDA collateral agreements to incorporate a fallback to €STR plus 8.5 basis points upon the cessation of EONIA.

03rd August 2021

The LMA published a note on its website giving practical guidance on amending loan documents for parties transitioning legacy LIBOR syndicated loans to compounded risk-free reference rates (RFRs).

23rd July 2021

ISDA announced the results of its consultation on the implementation of fallbacks for the sterling LIBOR ICE Swap Rate and the US dollar LIBOR ICE Swap Rate. The results indicated a significant majority of respondents agree with the fallback provisions set out in the draft amendments attached to the consultation. These amendments implement the fallbacks suggested by the Non-Linear Task Force of the Working Group on Sterling Risk-Free Reference Rates in the UK and a Subcommittee of the Alternative Reference Rates Committee in the US

14th June 2021

ISDA published the **2021 ISDA Interest Rate Derivatives Definitions**. The definitions consolidate the 70+ supplements since 2006 and incorporate the following updates:

- A new fallback trigger that will take effect if a party is prohibited from using a benchmark.
- Generic fallbacks for those floating rates with no existing fallback provisions.
- A new methodology to determine the cash settlement amount for swaptions and early terminations to reflect changes in market conventions and increased use of collateral.
- Modified calculation agent provisions to allow for determination under the new cash settlement and generic fallback provisions.
- Standardised naming conventions for floating rates, with the publication source excised from the definition.
- Revisions to payment and calculation provisions to allow for market closure.

14th June 2021

ISDA launched a consultation on how to implement fallbacks for Sterling and US dollar LIBOR ICE Swap Rates. The proposed fallbacks on which ISDA is consulting are:

- In relation to Sterling LIBOR, a SONIA ICE Swap Rate.
- In relation to US dollar LIBOR, a spread-adjusted SOFR Swap Rate.

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