BANK OF SCOTLAND

IBOR TRANSITION NEWSLETTER

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COMMERCIAL BANKING

TIME FOR ACTIVE TRANSITION

Welcome to our Newsletter. This is our fourteenth edition and it provides an update on the transition away from the London Interbank Offered Rate (LIBOR) and other Interbank Offered Rates (IBORs). The key topics for this month are:

- **ARE YOU READY?**
- **NO NEW GBP LIBOR LENDING & LINEAR DERIVATIVES – Q1 DEADLINE**
- **LMA NOTES FOR MARKET PARTICIPANTS**
- **TERM SONIA**
- **ISDA IBOR FALLBACKS COME INTO EFFECT**
- **TOUGH LEGACY – UK AND US PROPOSALS**
- **OTHER NEWS**

Please contact your Relationship Team if you have any questions or queries on the contents.

ARE YOU READY?

'Are you ready for life without LIBOR from the end-2021?' was the title of a speech given by Edwin Schooling Latter, Director of Markets and Wholesale Policy at the Financial Conduct Authority (FCA), on 26 January 2021. He highlighted that 85% of the uncleared UK derivatives market was now ready for the end of LIBOR and that the ICE Benchmarks Administration's (IBA) consultation on proposed end dates for LIBOR has now closed, opening the way to determining and announcing the future path for all 5 LIBOR currencies simultaneously. His concluding remark to the audience was 'press on with your transition'. These words, supported by the updated roadmap for 2021 from the Bank of England-initiated Working Group on Risk-Free Reference Rates (BoE WG) in early January, add to the expectation that all market participants will push forward with their transition activities in a timely way.

NO NEW GBP LIBOR LENDING & LINEAR DERIVATIVES – Q1 DEADLINE

As a reminder, the **end-Q1** deadline from the BoE WG for banks to cease issuance of a number of GBP LIBOR-based products, including lending and linear derivatives, expiring after end-2021 is fast approaching. The deadline applies to restructures of existing products, as well as new products.

We covered some of the market updates around lending in last month's newsletter, in the "Focus on GBP Loans" section.

For derivatives you may find it helpful to review our October newsletter, specifically the "GBP Sonia Liquidity in Focus" section. The Q1 deadline does not apply to risk management of existing positions. Linear derivatives include interest rate swaps and basis swaps. It does not include interest rate caps, interest rate floors, swaptions or constant maturity swaps.

LMA NOTES FOR MARKET PARTICIPANTS

The Loan Market Association (LMA) has published a series of notes for market participants. These cover the impact of LIBOR transition on LMA documentation outside of the context of investment grade English law documentation. The notes are supplementary to the most recent set of commentaries and exposure drafts that were issued at the end of January on rate switch and multi-currency compounded rate/term facility agreements. Secondary trading will be covered in an upcoming separate publication.

TERM SONIA

Refinitiv and IBA have launched Term SONIA (Sterling Overnight Index Average) reference rates. The intention is that usage will be limited to specific areas such as trade finance, as recommended by the BoE WG in January last year.

ISDA IBOR FALLBACKS COME INTO EFFECT

On 25 January the International Swaps and Derivative Association's (ISDA) new IBOR fallbacks came into effect, with more than 12,000 entities across nearly 80 jurisdictions already adhering to the related 2020 IBOR Fallbacks Protocol (Protocol). The Protocol allows firms to incorporate the fallbacks into their existing derivatives contracts referencing a number of IBORs, including LIBOR. Lloyds Bank plc, Bank of Scotland plc, Lloyds Bank Corporate Markets plc and Scottish Widows Limited have all adhered to the Protocol.

Scott O'Malia, ISDA's Chief Executive Officer, was careful to say in a press release that this was not "job done" in terms of derivatives transition. Fallbacks are a vital one-size-fits-all safety net, but regulators have emphasised that market participants may be able to better tailor the economic terms of their contracts by actively transitioning their portfolios to alternative rates before any cessation event. He also highlighted the matter of developing a solution for outstanding Tough Legacy exposures.

TOUGH LEGACY – UK AND US PROPOSALS

In his 26 January 2021 speech Edwin Schooling Latter also touched on the subject of Tough Legacy – these are contracts that genuinely cannot be transitioned away from LIBOR, nor be amended to apply an appropriate fallback, before the cessation date. He provided an insight into how the FCA might use their new powers to make changes to LIBOR's methodology and create a 'Synthetic LIBOR' for use only in such Tough Legacy situations following LIBOR's cessation or it being declared unrepresentative. The suggestion was that the rate could include a fixed credit adjustment spread similar to that used by the ISDA fallbacks; the spread becomes fixed only once an announcement of cessation or unrepresentativeness is made. In addition, he thought that 'Synthetic LIBOR' would be limited - and that Euro and Swiss franc settings, and lesser used tenors in any currency, would be neither desirable nor feasible.

A step closer to adopting a legislative approach to Tough Legacy in US jurisdictions was taken on 20 January 2021, when New York Governor Cuomo unveiled his state budget plan for the new fiscal year which included proposals to provide a legal safe harbour for a rate replacement needed to accommodate transition for certain USD LIBOR contracts governed by New York law. The legislation looks to enact the following outcomes:

- Any USD LIBOR contracts that do not contain a fallback rate, or do contain a fallback but to a LIBOR rate, will automatically transition from LIBOR to the benchmark replacement recommended by US regulators (i.e. SOFR (Secured Overnight Financing Rate) plus an adjustment selected by the regulator)
- Where the contract permits discretion in relation to a fallback rate, the parties will be able to elect to transition to the recommended benchmark replacement and will be protected from any civil liability for damages arising from exercising that option
- Any legacy language which includes a fallback based on LIBOR or other interbank funding rate will effectively be ignored

The legislation would take effect immediately once the budget is passed which is expected to be by 31 March 2021.

OTHER NEWS

The European Commission (EC) welcomed the agreement reached by the European Parliament and the European Council on amendments to the EU Benchmark Regulation. The amendments empower the EC to designate a replacement benchmark to cover all references to a widely used reference rate that is phased out, such as LIBOR, as and when necessary to avoid disruption in the EU financial markets.

On 4 December 2020 the Swiss Financial Markets Authority (FINMA) published guidance which recommends supervised institutions such as banks, securities firms and insurance companies take action to be fully prepared for the expected cessation of most of the widely-used LIBOR settings by end of 2021.

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