BANK OF SCOTLAND

IBOR TRANSITION NEWSLETTER

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COMMERCIAL BANKING

LIBOR'S END IS 'CERTAIN'

Welcome to our Newsletter. This is our fifteenth 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:

- **FCA ANNOUNCES CESSATION DATES**
- **ISDA CONFIRMS A CESSATION EVENT**
- **SUPPORT FOR STERLING TRANSITION**
- **MORE ON THE FCA'S PROPOSED POWERS**
- **ARRC RESPONDS TO FCA'S ANNOUNCEMENT**
- **A CLOSER LOOK: HELP FOR STERLING SYNDICATED LOANS**

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

FCA ANNOUNCES CESSATION DATES

The long-awaited formal announcement from the Financial Conduct Authority (FCA) on LIBOR cessation was made on 5 March 2021. It confirmed that all LIBOR settings will either cease or may become unrepresentative at a specific point in the future. The dates referenced were:

- immediately after 31 December 2021, in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month US dollar settings; and

- immediately after 30 June 2023, in the case of the remaining US dollar settings.

As part of the Bank of England's (BoE) reporting of the announcement. FCA CEO Nikhl Rati confirmed that there is now "certainty on when the LIBOR panels will end". Meanwhile, BoE Governor Andrew Bailey warned "with limited time remaining, my message to firms is clear – act now and complete your transition by the end of 2021".

Further details of the FCA announcement can be found here.

ISDA CONFIRMS A CESSATION EVENT

The International Swaps and Derivatives Association (ISDA) confirmed that the formal FCA announcement constituted an index cessation event for all LIBOR settings on 5 March 2021. This means that the spread adjustments (also referred to as the 5-Year Historic Median or 5YHM) published by Bloomberg are now fixed for all sterling, euro, Swiss franc, US dollar and Japanese yen LIBOR settings. A full l ist of these spread adjustments is available here.

ISDA also provided supporting guidance on how fallbacks specified in the terms of the ISDA 2020 IBOR Fallbacks Protocol, the IBOR Fallbacks Supplement and the 2006 ISDA Definitions Benchmarks Annex to the ISDA Benchmarks Supplement apply in relation to the FCA announcement, together with an article describing the change and its wider implications for the derivatives markets.

SUPPORT FOR STERLING TRANSITION

It is now clear that sterling LIBOR will no longer be representative and not be available immediately after 31 December. **Nevertheless, the Bank of England Working Group on Sterling Risk-Free Reference Rates (BoE WG) has set a more immediate interim milestone of 1 April, by which to stop using sterling LIBOR in new lending and linear derivatives (e.g. swaps) that mature after the end of 2021.**

To provide further assistance to all market participants to achieve these, and other, interim deadlines ahead of cessation, the BoE WG published several papers in February. For the derivatives market, there is a paper entitled the "Path to ending new use of GBP LIBOR-liked derivatives". Our "A closer look" section below provides more detail on the guidance that was published for the loan markets.

MORE ON THE FCA'S PROPOSED POWERS

As well as announcing the dates of LIBOR cessation, the FCA issued a statement of policy on how it intends to exercise some of its proposed new powers under the benchmark regulation to be granted in the upcoming Financial Services Bill.

The FCA will consult on the requirement for the continued publication of a small number of LIBOR settings, including 1, 3 and 6-month sterling LIBOR, on a non-representative, 'synthetic' basis. This is because they recognise that there are some existing LIBOR contracts which are particularly difficult to amend, often known as 'tough legacy'. This is however, not a way for market participants to transition to risk-free rates; the FCA is very clear that the permitted use of any synthetic LIBOR rate is expected to be limited.

Furthermore, the FCA has emphasised that any synthetic LIBOR setting will not be deemed to be representative and therefore is not to be used in new contracts. It is intended for use in tough legacy contracts only. A further FCA consultation will take place in Q2 2021 to determine which legacy contracts will be permitted to use synthetic LIBOR.

ARRC RESPONDS TO FCA'S ANNOUNCEMENT

The Alternative Reference Rates Committee (ARRC) in the US commended the announcements made by the FCA and the LIBOR administrator ICE Benchmark Administration (IBA) (here) . In a separate statement, it confirmed that in its opinion the announcements constitute a "Benchmark Transition Event" with respect to all US dollar LIBOR settings pursuant to the ARRC recommendations regarding more robust fallback language for new issuances or originations of LIBOR floating rate notes, securitizations, syndicated business loans, and bilateral business loans.

A CLOSER LOOK: HELP FOR STERLING SYNDICATED LOANS

To help borrowers and lenders prepare the BoE WG has published a Best Practice Guide for GBP Loans with a supporting Q&A. These are valuable resources as they provide a one stop shop for reference materials for anyone dealing with new sterling loans, and the transition of both bilateral and syndicated legacy lending.

Until recently, due to the complexity involved, progress on syndicated lending has been relatively slow. However the BoE WG papers describe the considerable work that has now been done to establish a set of market conventions for the sector. Reference is made to two compounding interest conventions – the cumulative compound rate and the non-cumulative compounded rate – both derive exactly the same interest values with the latter a feature of the syndicated market where daily calculations and allocations are required as part of the agent's settlement mechanics.

The work has also focused upon minimising the potential for friction caused by differences in practices and systems capability across syndicate members. So, in addition to agreement on interest conventions noted above, guidance is provided on the appropriate roles to be played by borrower, agent, lead/co-ordinating banks.

The BoE WG is clear that it is the responsibility of all market participants (arrangers, lending banks, institutional lenders, borrowers and sponsors) to work together on new SONIA (Sterling Overnight Index Average) based or alternative rate facilities to meet the upcoming deadline. The deadline applies equally to all lending in sterling, and includes the sterling component of a new/refinanced transition where the main drawn currency is not sterling, but where the client wishes to retain the option to draw in sterling or the sterling leg of an international loan syndicate.

In relation to any operational challenges, the FCA has said that institutions unable to provide risk-free reference rate products will have to accept that they cannot participate in syndicates, rather than trying to hold back others in the syndicate from moving away from sterling LIBOR. The BoE WG has said the lending market should not be restrained by the progress of the slowest firms and supervisors will take a keen interest and wish to be advised of any new, written sterling LIBOR lending (including re-financing) after the end of Q1 2021.

Finally, the BoE WG roadmap emphasises that all legacy sterling LIBOR contracts expiring after end 2021 need to be actively converted or have robust fallbacks in place before the end of September this year.

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