LOOKING TOWARDS THE FUTURE

Welcome to our Newsletter. This is our seventeenth edition providing an update on the transition away from the London Interbank Offered Rate (LIBOR) and other Interbank Offered Rates (IBORs). There are a number of important topics this month, which include:

- **KEY MESSAGES FROM THE OFFICIAL SECTOR**
- **WARNINGS FROM ISDA**
- **THE FINANCIAL SERVICES ACT AND SAFE HARBOUR**
- **MORE US TOUGH LEGACY LEGISLATION**
- **ARRC ON TERM RATES AND FAQS**
- **IBA CONSULTS ON GBP LIBOR SWAP RATE CESSATION**
- **NEWS FROM JAPAN**
- **A CLOSER LOOK: EURIBOR**

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

KEY MESSAGES FROM THE OFFICIAL SECTOR

At a SOFR Symposium hosted by the Alternative Reference Rates Committee (ARRC) on 11 May 2021, Andrew Bailey, Governor of the Bank of England and John Williams, President of the Federal Reserve Bank of New York both emphasised the central role that risk-free rates such as the Sterling Overnight Index Average (SONIA) should play in transition away from LIBOR in order to support global financial stability into the future. Term rates were also a topic of conversation at the event.

Andrew Bailey reminded the audience of “the important role benchmarks play in the financial system and why financial firms and borrowers would be well served in choosing the most robust alternative reference rates that meet their use case.” He pointed out that “UK supervisors have been consistent and clear that they support the industry agreed milestones of the Working Group on Sterling Risk-Free Reference Rates (BoE WG) and have set their expectations in line with these.”

Some of the key milestones include:

- **by end-Q1 2021, cease initiation of new sterling LIBOR-linked loans, bonds, securitisations and linear derivatives that expire after end of 2021 (except for risk management of existing positions)**
- **by end-Q2 2021, cease initiation of new sterling LIBOR-linked non-linear derivatives that expire after the end of 2021 (except for risk management of existing positions)**
- **by end-Q3 2021, complete active conversion of all sterling contracts where viable**

WARNINGS FROM ISDA

The milestones for transition in sterling markets were not the only focus this past month. Scott O’Malia, CEO of the International Swaps and Derivatives Association (ISDA), published an article on 22 April 2021 noting that whilst it may be tempting to look at the 30 June 2023 date, which has now been set for the cessation of most US dollar LIBOR settings, as an 18-month delay, the reality is “that firms need to prepare to use alternative reference rates for most new trades from the start of next year, irrespective of which LIBOR they use.” US regulators have been very clear that US-supervised entities should stop using US dollar LIBOR for new trades after the end of 2021.

“There are a few exceptions to this – for example, new transactions that reduce or hedge existing US dollar LIBOR exposure will be allowed – but the direction of travel is unambiguous”, he wrote.

Speakers on a LIBOR panel at the ISDA Annual General Meeting on 10 May 2021 reiterated the message that continued publication of certain US dollar LIBOR settings until mid-2023 should not be interpreted as a delay, and firms should step up their efforts to prepare to use alternative reference rates for all new trades by the end of this year.

The release of the article was followed by the publication on 27 April 2021 of the ISDA quarterly review of the transition to risk-free rates (RFRs).

FINANCIAL SERVICES ACT & SAFE HARBOUR

On 29 April 2021 the Financial Services Bill received Royal Assent and became an Act of Parliament. The Act makes extensive amendments to the legislative and regulatory framework of the UK's post-Brexit financial services landscape. Of relevance to LIBOR transition are amendments to the on-shored UK Benchmarks Regulation which provide the Financial Conduct Authority (FCA) with additional powers to manage an orderly wind-down of a critical benchmark (such as LIBOR) and extends the transitional period for third country (non UK) benchmarks. These powers include the ability to designate a “synthetic” LIBOR for use in “tough legacy” cases.

Earlier in the month, the Chair of the BoE WG, wrote a letter to the UK Treasury noting the absence of safe harbour protections within the Bill as envisioned in a previous consultation and asking whether any would be forthcoming. The letter made reference to recently introduced New York State LIBOR legislation, which includes a safe harbour provision for contracts governed by New York law. In their response to this letter HM Treasury advised that the UK Government does intend bringing forward further legislation to address the issues identified in the consultation.

MORE US TOUGH LEGACY LEGISLATION

In the US, following passage of NY State LIBOR legislation, the US House Committee on Financial Services’ Sub Committee on Investor Protection, Entrepreneurship and Capital Markets has considered the Adjustable Interest Rate (LIBOR) Act. The act will allow contracts referencing USD LIBOR without adequate fallback provisions upon USD LIBOR's discontinuation, to reference the Secured Overnight Financing Rate (SOFR) without the need for amendment or the concern of becoming subject to litigation. The legislation requires the Federal Reserve Board to establish regulations regarding how either SOFR or an adjusted SOFR should be used as a replacement reference interest rate for certain US dollar LIBOR-based contracts. Both the Structured Finance Association (SFA) and the Securities Industry and Financial Markets Association (SIFMA) expressed their support for the legislation.

ARRC ON TERM RATES AND UPDATED FAQS

Term Rates were also a topic of conversation at the *SOFR Symposium,* and followed publication by the ARRC of a set of market indicators that it will consider in recommending a forward-looking SOFR term rate. These market indicators are: continued growth in overnight SOFR-linked derivatives volumes; visible progress to deepen SOFR derivatives liquidity, consistent with ARRC best practices and visible growth in offering of cash products, including loans, linked to averages of SOFR, either in advance or in arrears. Term rates have become a hot topic over recent months, for more information please see the *A Closer Look* section of our April 2021 newsletter.

The ARRC also released a Guide to Published SOFR averages to provide market participants and non-financial corporates with key information on LIBOR transition, including how the published SOFR averages can be used today and what factors market participants should consider before selecting the alternative rates they use. The guide was released on the day of the SOFR Symposium to complement discussions.

An updated version of the ARRC’s FAQs, which provide further information about the work of the ARRC and market developments were published on 27 April 2021.

IBA CONSULTS ON STERLING LIBOR SWAP RATE CESSATION

On 7 May 2021 ICE Benchmark Administration (IBA) published a consultation on its intention to cease the publication of GBP LIBOR ICE Swap Rate settings for all tenors (from one to 30 years) immediately after publication on 31 December 2021.The consultation is open for feedback until 4 June 2021 and IBA will publish a feedback statement after the feedback period has closed. It was emphasised that the consultation is not, and must not be taken to be, an announcement that IBA will cease or continue the publication of GBP LIBOR ICE Swap Rate, or any other ICE Swap Rate settings, after 31 December 2021, or any other date.

NEWS FROM JAPAN

The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (BoJ WG) updated its "Roadmap to Prepare for the Discontinuation of Japanese Yen LIBOR" on 16 April 2021. This was to include a transition plan for interest rate swaps referencing Japanese yen LIBOR and maturing after the end of 2021.

Then, on 26 April 2021 the BoJ WG issued a statement that QUICK Benchmarks Inc. had begun publishing production rates for the Tokyo Term Risk Free Rate (TORF) for use in actual transactions. The rates are being made available on QUICK information terminals and the website of QUICK Corp ;they can also be accessed via the Bank of Japan's Interest Rate Benchmark Reform website.

A CLOSER LOOK: EURIBOR

Whilst Euro LIBOR (EUR-LIBOR) and the Euro Interbank Overnight Rate (EURIBOR) may sound similar they are completely different benchmarks. EURIBOR is widely used globally with, according to a report from the BoJ WG in July 2019, an estimated 150 trillion USD of outstanding transactions; this compares to "only" 2 trillion USD for EUR-LIBOR

The major difference in regard to transition is all EUR-LIBOR tenors are due to cease after 31 December 2021, while EURIBOR can continue to be used in new and legacy contracts for the foreseeable future. EURIBOR owes its extended life to methodological changes conducted over the course of 2019, which were aimed at making the benchmark more reflective of real marketplace transactions.

Notwithstanding this new lease on life, since 1st January 2018 it has been mandatory under Benchmark Regulations in the EU and the UK that all new regulated contracts which reference a benchmark (such as EURIBOR), include fallback provisions to deal with potential cessation and unrepresentativeness. Given the extensive use of EURIBOR in the European Union (EU) in July 2020 the European Central Bank (ECB) highlighted as an example of good practice that banks develop and implement fallback provisions for all affected contracts, irrespective of date, in order to be prepared for worst-case scenarios, such as the future unavailability or discontinuation of benchmark rates such as EURIBOR.

Supporting this regulatory initiative has been a primary focus of the Working Group on Euro Risk-Free Rates (EU RFR WG). In January 2019, it published a paper outlining some guiding principles for fallback provisions in new contracts for euro-denominated cash products.

More recently, on 11 May 2021, the EU RFR WG published its recommended EURIBOR fallback trigger events and rates which are intended to support market participants in developing contractual fallback provisions for a scenario in which EURIBOR may cease to exist. The recommendations are based on the feedback received from the public consultations on EURIBOR fallback trigger events and on €STR based EURIBOR fallback rates.

In summary, even though EURIBOR will be available for the foreseeable future, market participants must still ensure adequate fallback provisions are in place. A statutory replacement rate mechanism for contracts referencing critical benchmarks like EURIBOR, that are without appropriate fallbacks, does now exist for EU supervised entities after the EU amended the European benchmark regulation on 13 February 2021, with the terms of any change of replacement rate would ultimately at the discretion of the European Commission; whereas UK supervised entities would be subject to the FCA exercising the recently granted powers under the Financial Services Act.

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