

A low-angle, upward-looking photograph of several modern skyscrapers with glass facades. The buildings are set against a blue sky with some clouds. A large, semi-transparent, stylized number '1' is overlaid on the left side of the image, partially covering the buildings. The number is white with a blue gradient and a grid-like pattern.

LIBOR Transition Focus Areas

in 2020

LIBOR Transition Focus Areas

Work is progressing on the transition away from the London Interbank Offered Rate (LIBOR), but not as fast as the regulators would like. On November 21, 2019, the UK's Financial Conduct Authority (FCA) published a speech by Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA, on the transition from LIBOR. His speech outlined the progress made to date in anticipation of the end of 2021, after which the FCA will no longer compel or persuade banks to make LIBOR submissions. He acknowledged that while great strides have been made, there is still much work to do in transitioning to alternative, overnight near-Risk Free Rates (RFR). Meanwhile, the intervening COVID-19 pandemic — and attendant market volatility and liquidity issues — has diverted attention and resources away from LIBOR transition efforts. Regulators have acknowledged the challenges, but there is no evidence of plans to delay the established phase-out deadline. On March 25, 2020, the FCA, after discussions with the Bank of England and the Working Group on Sterling Risk-Free Reference Rates, published a statement confirming that “[t]he central assumption that firms cannot rely on LIBOR being published after the end of 2021 has not changed and should remain the target date for all firms to meet.” The FCA published a follow-up statement on April 29, 2020, reiterating that central assumption.

Scroll through or select a topic below ➡

1 Derivative Markets



International Swaps and Derivatives Association (ISDA) adoption of specified interbank offered rates (IBOR) fallbacks and publishing of replacement compounded setting in arrears “adjusted” RFRs, spread adjustments, and “all in” adjusted RFRs with spread adjustments, and the single-day, “big bang” transition for cleared swaps

Benchmark reform remains a key priority for ISDA in 2020. Published in 2018, the ISDA Benchmarks Supplement provides generic fallbacks for transactions that reference benchmarks. By January 14, 2020, 228 ISDA members adhered to the associated protocol. While the ISDA Benchmarks Supplement provides a mechanism for determining alternative rates, it does not hard-wire actual replacements.

ISDA continues to work on a more permanent solution, with IBOR fallbacks to be hardwired into the ISDA 2006 Interest Rate Definitions. Following various industry consultations conducted in 2019, ISDA intends to finalize in early 2020 its amendments to definitions to incorporate robust contractual fallback provisions for nine key IBORs in various currencies. The fallbacks would provide for RFRs as replacement reference rates applicable in the event of permanent discontinuation of each relevant IBOR.

On January 13, 2020, ISDA published an IBOR Fallback Rate Adjustments FAQ document, which addresses issues arising from key adjustments necessary for the application of RFR fallbacks to existing IBOR-referenced contracts. ISDA also plans to publish a protocol to enable

market participants to include optional fallbacks within legacy IBOR contracts, including certain non-ISDA derivative contracts, such as repurchase and securities lending agreements.

Since RFRs are structurally different from IBORs, certain adjustments will need to be applied if the fallbacks are triggered and the replacement rates applied to IBOR-based contracts, in order to account for the fact that an RFR is an overnight rate, while IBORs have term structures (e.g., one-, three-, six-month LIBOR); and the historical spread differential between IBORs and their “term equivalent” RFR compounded rates.

Following extensive market consultations, ISDA concluded that the most appropriate methodology for calculating a credit adjustment spread for fallbacks on cessation of LIBOR would be a historical median over a five-year lookback period. Bloomberg was chosen as the adjustment services vendor to calculate and publish the term and spread adjustments for IBOR fallbacks, based on ISDA’s adjustment methodology. Bloomberg will calculate and publish the following:

1. Compounded setting in arrears for each RFR for each relevant term adjusted RFR based on the daily compounding of publicly available RFRs published by central banks
2. Spread adjustments based on the median of the historical differences between the IBOR for each tenor and the compounded RFR for that tenor over a five-year period prior to an announcement triggering a fallback provision, and
3. The “all in” fallback rate, which is the combination of the adjusted RFR and the spread adjustment for each relevant tenor

Furthermore, to promote secured overnight financing rate (SOFR) liquidity in the cleared swaps market, CME Group confirmed late in 2019 that it will transition from LIBOR to SOFR as the reference rate for discounting cleared USD interest rate swap (IRS) products on October 16, 2020. The single-day transition was revised to coincide with LCH’s transition plan. Such a coordinated, single-day transition — being coined in the market as the “big bang” — is intended to rapidly accelerate the development of liquidity in SOFR-linked after the target transition date.

2 US Dollar Markets



Transition from USD LIBOR to the Secured Overnight Financing Rate (SOFR) and development of spread adjustment methodologies for non-derivative cash products referencing USD LIBOR; the Federal Reserve Bank of New York is now publishing 30-, 90-, and 180-day compounded averages of SOFR

After the FCA announced it would phase out IBORs in 2021, the US Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York convened the Alternative Reference Rates Committee (ARRC) to identify an alternative reference rate to USD LIBOR. The ARRC selected SOFR from numerous alternative rates and has since worked to create an implementation plan to support the adoption of SOFR in various financial products that reference LIBOR. Advocates of SOFR maintain that SOFR was chosen, because, according to Tom Wipf, chair of the ARRC, “it is robust, reliable through economic cycles and better reflects the way financial institutions fund themselves.”

There are critical differences between LIBOR and SOFR that complicate the transition from one rate to another in affected contracts.

In the US, there is still much work to be done to develop liquidity in SOFR. There are critical differences between LIBOR and SOFR that complicate the transition from

one rate to another in affected contracts. LIBOR is an estimated unsecured interbank lending rate published for different interest periods. It is a forward-looking rate, meaning the borrower knows the interest rate on the loan at the beginning of the interest period. In contrast, SOFR is a secured, nearly risk-free rate, and there are several variants of SOFR that can be used. SOFR, however, is an overnight rate that is backward-looking, and therefore lacks term rates and a yield curve.

Because SOFR is based on actual secured overnight transactions in the Treasury repurchase (repo) market, it is also subject to instances of volatility caused by stress and irregularities in the repo funding market. For instance, on September 17, 2019, SOFR spiked from 2.43% to 5.25%, and returned to 2.55% the following day, causing many market participants to question its stability. Further concerns about stability and suitability have emerged since the Federal Reserve announced emergency rate cuts in March 2020 to contain the fallout from the COVID-19 pandemic. The divergence between LIBOR (and other lending benchmarks) and SOFR has since widened dramatically, with LIBOR over 100 basis points higher than SOFR (as of April 28, 2020, SOFR stands at 0.01% and three-month LIBOR at 1.04%).

The ARRC continues to drive the transition away from LIBOR to SOFR. On January 31, 2020, the ARRC published a useful implementation checklist for buy-side firms transitioning from LIBOR to SOFR. The checklist includes recommendations on various considerations firms are facing during the transition phase, including establishing accountability, robust governance, exposure and impact assessment, contract remediation, risk-management, communication strategy, and operational readiness.

Following on its prior consultation to develop standard fallback language and cessation triggers, the ARRC launched another industrywide consultation on January 21, 2020, that addresses spread adjustment methodologies for cash products referencing USD LIBOR. The consultation sought input from market participants on the calculation of spreads at the time of a trigger event (cessation) to account for and minimize changes in value that would result from a switch from LIBOR to SOFR. The consultation closed on March 25, 2020.

3 Loan Markets



Continued efforts by the Alternative Reference Rates Committee (ARRC) to promote fallback language in syndicated loans and by the Loan Syndications and Trading Association (LSTA) and the Loan Market Association (LMA) to develop market consensus in respect of new compounded SOFR and Sterling Overnight Index Average (SONIA) products

As part of its implementation plan to support adoption of SOFR in various financial products that reference LIBOR, the ARRC released in April 2019 recommended fallback language for syndicated loans (ARRC Fallback Language) to incorporate into credit agreements to reduce the risk of serious market disruption following LIBOR cessation. The ARRC Fallback Language includes two alternatives upon certain trigger events or early opt-in by the parties:

1. the “amendment” approach, which contemplates the administrative agent and borrower selecting a replacement benchmark rate and spread adjustment, with an amendment implementing the changes subject to a five-business-day period during which majority lenders may object, and
2. the “hardwired” approach, in which the parties agree to a replacement benchmark rate and spread adjustment, determined by a waterfall of options.

Related to the ARRC’s implementation efforts, the LSTA released on February 26, 2020 (after an initial release on October 1, 2019) a draft concept credit agreement referencing SOFR in an effort to educate market participants on the replacement benchmark.

The draft concept credit agreement references a compounded average of daily SOFR calculated in arrears, *i.e.*, the rate is not known until the end of the interest period. Although this is a dramatic change from the way loans and lenders’ systems operate today, the LSTA included this type of SOFR because it already is referenced by many SOFR floating rate notes and will be incorporated into ISDA standard definitions this year as the designated fallback rate for USD LIBOR derivatives. Since customary LIBOR break funding provisions do not directly translate to daily SOFR, a bracketed section to allow for lenders to recoup losses due to an intra-period payment is included. Consideration of lenders’ cost of funding and breakage indemnities remains an open discussion point.

As an alternative, the LSTA released on March 6, 2020, an initial draft of a concept credit agreement referencing simple SOFR. The “Simple SOFR in Arrears” is calculated by taking a simple average of daily SOFRs for the duration of the interest period. Comments from LSTA members on the compounded SOFR credit agreement were due at the end of March, while comments on the simple SOFR credit agreement were due on April 17, 2020. The LSTA will publish both agreements in final form after considering all feedback.

Despite the ARRC’s and LSTA’s efforts, however, Covenant Review found in a recent study that only 33% of deals that came to market in the fourth quarter of 2019 used the ARRC Fallback Language amendment approach, and no deals included the hardwired approach. Seemingly, market participants are waiting for more clarity around SOFR before making the transition.

Across the Atlantic, the LMA published in 2018 a recommended form of replacement screen rate provision, which allows borrowers and the agent (expressly acting on the instructions of the majority lenders) to agree to an amendment or waiver relating to the use of a replacement benchmark on the occurrence of a screen rate replacement event. The amended screen rate replacement approach introduced by the LMA stands in contrast to the previously favored unanimous lender consent approach.

Unlike the LSTA, the LMA did not initially focus on adopting specified RFR fallbacks to discontinued IBORs. Following its survey of LIBOR fallback provisions, which concluded on December 31, 2019, Covenant Review looked at newly issued and amended loans in the European leveraged loan

3 Loan Markets *continued*



Continued efforts by the Alternative Reference Rates Committee (ARRC) to promote fallback language in syndicated loans and by the Loan Syndications and Trading Association (LSTA) and the Loan Market Association (LMA) to develop market consensus in respect of new compounded SOFR and Sterling Overnight Index Average (SONIA) products

market and found the majority of European loans favor the LMA-recommended language based on majority lender consent. However, the report also noted that not all loan agreements contemplate a replacement screen rate, which means that further amendments will be necessary.

However, in September 2019, the LMA published exposure drafts of a compounded SOFR-based USD term and revolving facilities agreement and a compounded SONIA-based sterling term and revolving facilities agreement. In October 2019, the LMA also published an exposure draft of a reference rate selection agreement in an effort to streamline the transition process from LIBOR to specified reference rates for legacy facility agreements.

Not all loan agreements contemplate a replacement screen rate, which means that further amendments will be necessary.

The LMA envisages that transaction parties will use the same form of reference rate selection agreement in a range of transactions in order to agree to the basic commercial terms for selecting alternative reference rates, and to (pre-)authorize the agent and the obligors to determine the necessary future amendments to the relevant facility agreement. Adopting alternative reference rates is a two-stage process: first, lenders and obligors agree the commercial terms of the reference rate that will replace LIBOR in the reference rate selection agreement; second, agent and obligors make the required amendments to the facility agreement without further consents.

The LMA published the exposure drafts to facilitate awareness of the issues involved in structuring syndicated loans referencing compounded SOFR, SONIA, or other RFRs. Lenders may increasingly adopt the new documentation over the course of 2020.

Key issues for parties negotiating loan transactions include:

1. The replacement benchmark rate that will be used
2. Agreement on the replacement benchmark rate
3. The benchmark replacement trigger event
4. Replacement mechanics and implementation

"I have warned that firms must not assume LIBOR will continue beyond end-2021 even if transition is not substantially complete. I repeat that warning today."

Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA

4 Securitization Markets



LIBOR replacement mechanics and provisions related to the securities issued in the securitization and related to the underlying portfolio of assets continue to be developed in the market

The securitization markets need to address a number of issues, including basis risk on, and between, securities and corresponding underlying collateral, as well as complexities resulting from the multiple parties involved in a securitization and documentation. For new securitizations, some market participants are implementing more robust fallback language such as the ARRC's proposed fallback language or similar language proposed by the Structured Finance Association (SFA), but much work remains, according to the SFA.

For new securitizations, some market participants are implementing more robust fallback language.

In a move that is expected to promote LIBOR transition to Risk-Free Rates (RFRs) in securitized markets, Fannie Mae and Freddie Mac announced on February 5, 2020, that they will stop accepting adjustable-rate mortgages that they hold or package into mortgage-backed securities (MBS), if they are tied to LIBOR. Both Fannie Mae and Freddie Mac are US government-sponsored entities that provide housing market liquidity by buying mortgage loans from commercial and thrift banks.

As members of the ARRC, they presumably support SOFR as the preferred benchmark alternative to LIBOR, but the organizations have not officially mandated its use in new or legacy contracts.

In response to the financial uncertainty created by the COVID-19 pandemic, the US Federal Reserve announced a new Term Asset-Backed Securities Loan Facility (TALF) on March 23, 2020, with the pricing of its collateralized loan obligations (CLOs) based on SOFR. The TALF program intends to support the flow of credit to consumers and businesses by enabling the issuance of asset-backed securities (ABS) backed by certain types of eligible collateral, including student loans, auto loans and leases, credit card receivables, small business loans guaranteed by the Small Business Administration (SBA), equipment loans, and certain other assets. Its scope was expanded by the Federal Reserve on April 9, 2020, to provide additional liquidity for certain commercial mortgaged-backed securities (CMBS) and CLOs. The pricing for the CLOs will be based off the 30-day average secured overnight financing rate (SOFR) (pricing set at SOFR+150 basis points).

"Firms that have not begun this work in earnest, and do not have plans to complete it by end-2021, run significant financial and reputational risks. Firms need to end use of Libor in new contracts as soon as possible and, where possible, to accelerate their efforts to remove their reliance on Libor within legacy contracts."

**Randal K. Quarles, Vice Chair for Supervision,
the Board of Governors of the Federal Reserve
System**

5 Sterling Markets

£

Establishment of consensus toward adjusted RFR calculation and spread adjustment methodologies in respect of non-derivative cash products in the sterling markets

Following the 2017 announcement by the FCA of the intended discontinuation of LIBOR, the Working Group on Sterling Risk-Free Reference Rates (Sterling RFR Working Group) recommended the adoption of SONIA as the successor to Sterling LIBOR. The market for SONIA derivatives is already well-established. According to the FCA and Bank of England, average cleared over-the-counter SONIA swaps exceeded £4.5 trillion per month in the six months leading up to January 2020, and the traded monthly notional value is now broadly equivalent to Sterling LIBOR.

Progress has been uneven among non-derivative (*i.e.*, cash) products, such as loans, bonds, and securitizations. SONIA (compounded daily with a five-day lookback period) has been adopted as the preferred RFR for new issues of sterling floating rate notes (FRNs). In the securitization markets, virtually all new issues of sterling-denominated securitizations reference SONIA instead of LIBOR. However, challenges remain. Many legacy bond terms and conditions contain fallback provisions (*e.g.*, falling back to a fixed rate) designed for a temporary cessation of LIBOR. In addition, securitization issuers need to consider hedging the potential mismatch between notes that reference alternative rates and underlying assets that still reference LIBOR.

LIBOR-based products issued after the FCA's announcement tend to contain more sophisticated fallback provisions. For such products, there has been a proliferation of risk factors in related prospectuses and other disclosure documents addressing uncertainty relating to various issues, including the consequence of failure to select an alternative rate, the ability of alternative rates to produce a comparable result, and whether the general increased regulatory scrutiny of LIBOR could increase the costs and risks of administering or otherwise participating in the setting of a LIBOR rate.

LIBOR-based products issued after the FCA's announcement tend to contain more sophisticated fallback provisions.

The Sterling RFR Working Group recommended that legacy bonds be amended or replaced before the fallback provisions are triggered, in order to allow for an orderly transition from LIBOR to SONIA. There has been some success in this area; in January 2020, the Bank of England identified eight consent solicitations with a total nominal

value of £4.2 billion that were announced publicly as having successfully transitioned from LIBOR to SONIA.

LIBOR remains common in corporate lending, including in syndicated loans. One of the main challenges to transitioning from Sterling LIBOR to compounded SONIA is the lack of a market-accepted convention for calculating compounded SONIA in the loan market. However, the free online calculator tool launched in July 2019 by NatWest Markets to aid in the calculation of daily compounded SONIA may help to facilitate progress towards the Sterling RFR Working Group's stated target to end new Sterling LIBOR-based lending by Q3 2020.

Following the progress made by ISDA, the Sterling RFR Working Group published a December 2019 consultation paper for the sterling cash market (loans, bonds, and securitizations). The paper highlighted the need for cash markets to adopt a common methodology for determining credit adjustment spreads in respect of fallbacks referencing Sterling LIBOR to SONIA. The paper acknowledged the importance of achieving consistency with the credit adjustment spread methodology identified by ISDA, in which derivatives are used to hedge interest rate risk in cash products. However, the paper also noted

5 Sterling Markets *continued*

£

Establishment of consensus toward adjusted RFR calculation and spread adjustment methodologies in respect of non-derivative cash products in the sterling market

that ISDA's consultations did not include coverage of non-derivative products, and ISDA's credit spread methodology will result in a static figure that will not reflect changes in the interbank market once the fallback is applied.

In its consultation, the Sterling RFR Working Group is seeking market consensus in respect of either of the following:

- Including fallbacks to RFRs in contracts that reference LIBOR
- Transitioning to RFRs from LIBOR

The feedback to the consultation will likely facilitate a market standard in 2020.

The Bank of England, the FCA, and the Sterling RFR Working Group published a suite of documents on January 16, 2020, outlining priorities and milestones for 2020 on LIBOR transition. As part of this, the Sterling RFR Working Group's Term Rate Use Case Task Force published a working paper on the development and use of a forward-looking, term-based SONIA. Although a term SONIA rate does not exist today, administrators are working on the development of an International Organization of Securities Commissions-compliant (IOSCO-compliant) rate, which is expected to be published in early 2020 for a period of observation so that market participants can understand the nature and behavior of the rates before they are used in actual financial products. However, the Sterling RFR Working Group's prevailing view is that backward-looking, daily compounded SONIA should be the norm and future use of a term SONIA should be limited to certain specified circumstances, in contrast to current use of Sterling LIBOR.

Additionally, the Bank of England has introduced a further measure designed to encourage a faster move away from LIBOR to SONIA — increased “haircuts” on LIBOR-linked collateral. The Bank of England will apply a discount from October 2019 to the value of LIBOR-linked collateral that commercial banks can post to secure loans. This so-called haircut, the difference between what the Bank of England will accept as collateral and what it will lend at, will be increased and will reach 100% by the end of 2021 (when firms are required to switch away from LIBOR). Any LIBOR-linked collateral issued after October 2020 this year will be ineligible for use as collateral for loans, in order to discourage future LIBOR use.

6 Euro Markets



Continued transition from Euro LIBOR and adjusted Euro Overnight Index Average (EONIA) towards the new €STR benchmark, and adoption of fallbacks for Euro InterBank Offered Rate (EURIBOR)

On May 31, 2019, the European Money Markets Institute (EMMI), the administrator of the EONIA benchmark, changed the methodology for calculating EONIA to be based on the euro short-term rate (Euro STR, or €STR), which launched in October 2019, plus a spread of 8.5 basis points. On January 3, 2022, EMMI will discontinue “€STR-dependent” EONIA under the recalibrated methodology, and market participants will need to transition a second time to “€STR flat” (i.e., without the additional spread).

On October 1, 2019, ISDA published Supplement 59 to the 2006 ISDA Definitions, which adds a compounded €STR Floating Rate Option to the 2006 ISDA Definitions. On the same day, ISDA published Supplement 60, which amends the EONIA Floating Rate Options to embed fallbacks upon the permanent cessation of EONIA (the first fallback being to €STR + 8.5bps). This means that following permanent cessation of EONIA and absent agreement between the parties to the contrary, €STR plus 8.5 bps will apply as fallback to transactions which incorporate the terms of the ISDA Benchmarks Supplement.

A supplemental consultation was recently launched on the spread and term adjustments that would apply to €STR fallbacks for derivatives referencing Euro LIBOR and EURIBOR (as well as less widely used IBORs) if those benchmarks are permanently discontinued. This consultation closed on January 21, 2020.

On February 14, 2020, ISDA published the ISDA Collateral Agreement Interest Rate Definitions, which enables parties to include standardized definitions relating to overnight interest rates in ISDA published collateral agreements such as credit support annexes for variation margin. The first version of the ISDA Collateral Agreement Interest Rate Definitions includes definitions of EONIA (Collateral Rate) and €STR (Collateral Rate). Other overnight interest rates will be added in subsequent versions later in the year.

Although the Working Group on Euro Risk-Free Reference Rates (Euro RFR Working Group) is chiefly concerned with the transition from EONIA to €STR, it is also looking at identifying fallbacks for the EURIBOR based on €STR.

Both backward- and forward-looking options are being considered. That being said, the case for agreeing fallbacks to EURIBOR is less urgent, as there are no plans to permanently discontinue EURIBOR. On July 2, 2019, EMMI received authorization from the Financial Services and Markets Authority of Belgium to act as administrator for a reformed EURIBOR under new, hybrid methodology. As a result, EURIBOR will be, at least in the foreseeable future, in compliance with the EU Benchmarks Regulation (BMR) and available for use by EU-regulated financial institutions.

7 EU Benchmarks Regulation and Brexit



The effect of Brexit on EU and UK regulated benchmarks, benchmark administrators, and users

Under the BMR, EU-supervised financial institutions can only use benchmarks that appear on a register maintained by the European Securities and Markets Authority (ESMA). This includes benchmarks that either (i) are provided by an authorized or registered EU administrator, or (ii) qualify for use in the EU under the BMR third-country regime. The third-country regime enables third-country benchmarks to qualify for use in the EU in one of three ways:

1. **Equivalence** — Through which the European Commission has adopted an equivalence decision, and the third-country administrator is regulated and supervised in its home jurisdiction
2. **Recognition** — Through which a third-country administrator has a legal representative in the EU that has been recognised by, and is accountable for, its oversight of the third-country administrator to an EU competent authority
3. **Endorsement** — Through which an EU-regulated administrator takes responsibility for the benchmark and its compliance with the BMR requirements

As a result of Brexit, LIBOR is highly likely to be classed as a third-country benchmark from an EU perspective.

The third-country regime is subject to transitional arrangements, meaning that EU-supervised financial institutions may continue to use all third-country benchmarks for a period of time before the restrictions on use in the EU begin to apply. At the end of 2019, this transitional period was extended to the end of 2021, meaning that from January 1, 2022, EU-supervised financial institutions may only enter into new use of third-country benchmarks if they qualify for use in the EU under the third-country regime set out above.

However, due to the likely impact of Brexit, this creates an unfortunate timing clash between the potential cessation of LIBOR at the end of 2021 and the end of the transitional period for third-country benchmarks. As a result of Brexit, LIBOR is highly likely to be classed as a

third-country benchmark from an EU perspective (because it is administered in the UK, which after Brexit will be considered a third country). Given this, EU users of LIBOR will only be able to continue to reference LIBOR in new documentation from January 1, 2022, if LIBOR qualifies for use under the third-country regime, which is unlikely to be the case.

The same will be true for any successor rates which, if created before the end of 2021, will benefit from the transitional period, but must qualify for use in the EU by January 1, 2022, for new use to be permitted past that date. If replacement rates are created after the end of 2021, they will not benefit from the BMR transitional period and will need to qualify for use in the EU before they may be used by EU supervised financial institutions.

This is further complicated by the fact that, from a UK perspective, it is highly likely that EU benchmarks will be classed as third-country benchmarks post-Brexit under the UK “onshored” version of the BMR. Therefore, any replacement EU rates would need to qualify under the UK

7 EU Benchmarks Regulation and Brexit *continued*



The effect of Brexit on EU and UK regulated benchmarks, benchmark administrators, and users

specific third-country regime (which mirrors the regime set out above) in order to be used by UK supervised financial institutions.

There will still ultimately be two regimes to satisfy if third-country administrators wish to provide their benchmark into both the UK and EU.

There will also be an additional regulatory burden for benchmarks from outside the UK and the EU. At present, third-country benchmarks need to qualify under the BMR third-country regime to be used in the EU (including at present the UK); whereas post-Brexit, they will need to qualify under both the EU and UK regimes for use across Europe and the UK. In the absence of other arrangements being agreed, the UK plans to include a transitional period for third-country benchmarks until the end of 2022 in the UK onshored version of the BMR (a year longer than the transitional period under the BMR).

However, at present, there will still ultimately be two regimes to satisfy if third-country administrators wish to provide their benchmark into both the UK and Europe. This presents an extra compliance issue for third-country benchmark providers, which could cause issues in relation to the transition from LIBOR to new rates if there is not the requisite impetus for providers to ensure their benchmarks qualify for use in both the UK and EU.

8 Disclosure



Impact of LIBOR transition risks in disclosure documents where applicable

According to the US Securities and Exchange Commission (SEC) in its July 2019 Staff Statement on LIBOR Transition, “[a] number of existing rules or regulations may require disclosure related to the expected discontinuation of LIBOR, including rules and regulations related to disclosure of risk factors, management’s discussion and analysis, board risk oversight, and financial statements.”

The SEC’s Division of Corporation Finance provided guidance in the July 2019 Staff Statement for companies to determine the relevance and appropriateness of disclosures to investors on transition risk-management.

The guidance recommends that companies consider:

- Disclosing the status of past and current efforts, while outlining outstanding issues to be addressed and related plans
- Disclosing the results of exposure assessments and impact estimates, whether known or yet to be determined
- Sharing qualitative and quantitative information used by management and the board concerning exposure impact, transition management, and risk mitigation

“The expected discontinuation of LIBOR could have a significant impact on the financial markets and may present a material risk for certain market participants, including public companies, investment advisers, investment companies, and broker-dealers. The risks associated with this discontinuation and transition will be exacerbated if the work necessary to effect an orderly transition to an alternative reference rate is not completed in a timely manner.”

The US Securities and Exchange Commission
Staff Statement on LIBOR Transition

9 Regulatory Pressure



Increased regulatory pressure to end new LIBOR issuance and transition legacy contracts

Advisory bodies such as the Financial Stability Board (FSB), central banks, and global regulators are encouraging financial institutions to accelerate their LIBOR transition planning and execution. The FSB has also been urging firms to speed up their move away from LIBOR. The FSB plans to conduct a survey of financial institutions' exposures to LIBOR and the supervisory measures in place to address problems with the transition, and plans to share its findings with G20 finance ministers and central bank governors in July 2020.

The FSB has been urging firms to speed up their move away from LIBOR.

In the US, the SEC issued a comprehensive Staff Statement on LIBOR Transition on July 12, 2019, with significant context and guidance (from the Divisions of Corporation Finance, Investment Management, Trading and Markets, and the Office of the Chief Accountant) on how market participants can proactively manage their transition away from LIBOR, and mitigate the associated financial and market risks.

Other major US federal regulators — such as the Federal Reserve and the Office of the Comptroller of the Currency — have intensified their calls to market participants to make measurable transition progress, and have indicated there will be increased oversight and testing of LIBOR transition planning and risk-management.

At the state level, the New York State Department of Financial Services (NYSDFS, New York State's supervisor and regulator of approximately 1,500 banking and other financial institutions, including 122 state-chartered banks and 80 foreign branches) requested at the end of 2019 that banks and insurers submit LIBOR transition and risk management plans. Responses were initially due by February 7, 2020, but regulators granted a one-time extension until March 23, 2020. The NYSDFS emphasized in its request the pressing responsibility of market participants to minimize LIBOR cessation impacts and transition risks.

In the UK, regulators have published a series of speeches setting out their expectations regarding the transition away from LIBOR, and have sent letters to senior management at larger financial institutions and asset managers to explain

what progress the regulators expect to see and to make clear that firms should operate on the basis that LIBOR will not be available after the end of 2021.

The FCA recognizes that the impact of COVID-19 may affect some of the interim transition deadlines, in particular within the loan market.

Further, in November 2019, the FCA published guidance for financial institutions regarding conduct risk and LIBOR, emphasizing that financial institutions need to be aware of issues such as treating customers fairly as part of their transition planning, as well as focusing on prudential and operational risks. As mentioned above, on January 16, 2020, the Bank of England and the UK's Sterling RFR Working Group released a suite of documents which collectively set out the UK regulators' expectations on the timing of the transition from sterling LIBOR to the SONIA risk free rate, as well as other important guidance.

9 Regulatory Pressure *continued*



Increased regulatory pressure to end new LIBOR issuance and transition legacy contracts

This included guidance relating to consent solicitations to amend legacy GBP LIBOR-linked instruments and for the development of a term SONIA reference rate (TSRR), making clear that they expect the transition from LIBOR to be primarily to compounded SONIA as opposed to a new forward-looking term SONIA. Within these documents, the FCA and the Bank of England identified March 2, 2020, as the date on which the market convention for Sterling interest rate swaps should change from LIBOR to SONIA. UK firms should be aware of the risk of regulatory action if they fail to take action on LIBOR transition.

The UK regulators have also sent a letter on LIBOR discontinuation to UK trade associations representing non-financial businesses explaining how LIBOR discontinuance may affect their members and stakeholders. The letter asks the trade associations to help raise awareness among their networks and gives advice on doing so. This demonstrates the importance the UK regulators place on general market awareness of the risks of LIBOR transition and that this should not be limited to stakeholders in the financial markets, but to all those who may have exposure to LIBOR products.

As noted earlier, the intervening COVID-19 pandemic has presented urgent financial and operational challenges to financial institutions. Many stakeholders have warned that resources are being consumed by the urgent demands of the moment, and have called on regulators to consider relief. Regulators, such as the FCA, have acknowledged such challenges, but have thus far remained steadfast in the long-term transition deadline and objectives. The FCA does, however, recognize that the impact of COVID-19 may affect some of the interim transition deadlines, in particular within the loan market.

10 Artificial Intelligence



Increased adoption of artificial intelligence and other innovations in migrating legacy contracts to the new benchmark rate

Artificial intelligence (AI) continues to gain traction as a compelling method for financial institutions to “repaper” a high volume of legacy contracts. Many banks and buy-side firms lack adequate resources to quickly and accurately scope IBOR exposure. AI may prove indispensable for these institutions facing the operational challenges posed by the looming end-2021 deadline and the heavy volume of contracts in need of remediation.

While AI is no substitute for informed leadership and methodical planning, it can assist in the execution phase of contract remediation when volume is an issue. As with all technology solutions, firms should consider testing and adoption sooner rather than later to account for trial and error, learning curves, uptake, and oversight.

Latham & Watkins *Client Alert*: LIBOR Discontinuation and Transition — What Investment Managers Should Know

The global shift away from LIBOR presents a complex, time-sensitive, multifaceted set of challenges and tasks for the investment management industry.

To continue to read this *Client Alert*, please click [here](#)

Contacts

Nicola Higgs

Partner

T +44.20.7710.1154

E nicola.higgs@lw.com

Vicki Marmorstein

Partner

T +1.213.891.8340

E vicki.marmorstein@lw.com

Victoria Sander

Partner

T +44.20.7710.5814

E victoria.sander@lw.com

Jane Summers

Partner

T +1.212.906.1838

E jane.summers@lw.com

Yvette Valdez

Partner

T +1.212.906.1797

E yvette.valdez@lw.com

Douglas Yatter

Partner

T +1.212.906.1211

E douglas.yatter@lw.com

Becky Critchley

Associate

T +44.20.7710.1000

E becky.critchley@lw.com

Monika Thull

Associate

T +1.213.891.8951

E monika.thull@lw.com

Deric Behar

Knowledge Management Lawyer

T +1.212.906.4534

E deric.behar@lw.com

Charlotte Collins

Knowledge Management Lawyer

T +44.20.7710.1804

E charlotte.collins@lw.com

Angela LaVigne

Knowledge Management Lawyer

T +1.212.906.3865

E angela.lavigne@lw.com

Christopher Sullivan

Knowledge Management Lawyer

T +44.20.7710.4524

E christopher.sullivan@lw.com

Sindhoo Vinod

Knowledge Management Lawyer

T +44.20.7710.1885

E sindhoo.vinodsabharwal@lw.com