Financial Markets Law Committee ("FMLC")

Infrastructure Scoping Forum

Date: Thursday 9th May 2019

Time: 2.00pm to 3.30pm

Location: Shearman &Sterling LLP (UK), —9 Appold St, Hackney, London EC2A 2AP

In Attendance:

Thomas Donegan (Chair)	Shearman & Sterling LLP
Antony Beaves	Bank of England
Natalie Lewis	Travers Smith
Hannah Meakin	Norton Rose Fulbright LLP
Nathan Renyard	Cboe Europe
Michael Sholem	CWT LLP
Julia Smithers-Excell	White&Case LLP
Ferdisha Snagg	Cleary Gottlieb Steen &Hamilton
Paul Watkins	Blue Nile
Virgilio Diniz	FMLC

Guest Speaker:

Bruce Johnston	Morgan Lewis & Bockius LLP

Regrets:

Nick Carew Hunt	
Emma Dwyer	Allen & Overy LLP
Mark Evans	Travers Smith LLP
John Ewan	
Iona Levine	Minerva Chambers
Rachel Pearson	ICE
Alex Rutter	Tradeweb
Mitja Siraj	FIA – Futures Industry Association

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Minutes:

1. Introductions

1.1. The Chair opened the meeting and asked attendees to introduce themselves.

2. Administration: FMLC in numbers (Virgilio Diniz)

2.1. Mr Diniz provided attendees with an update on the performance of the FMLC in 2018.

3. Introductory remarks on EMIR Refit (Thomas Donegan)

3.1. The chair presented introductory remarks on the EMIR Refit. In his view, EMIR had given rise to various technical difficulties affecting both non-financial counterparties ("NFC") and financial counterparties ("FC"). The European Commission was required to carry out a review after the regime had been introduced and made a proposal to amend and simplify EMIR in order to address compliance costs and transparency issues for NFCs. He explained the proposed key changes to EMIR, such as changes to the FC definition, a new clearing threshold for FCs, revised clearing obligation triggers and provisions allowing suspension of clearing obligation among others. He also briefly described the interaction of EMIR Refit with national insolvency laws, stating that there were substantial uncertainties in relation to the "porting" and "leapfrog" provisions under EMIR. He expressed the hope that , member state legislators would now bring their laws into lines observing that the UK is one of only a handful of E.U. countries to have done so.

3.2. Mr. Donegan highlighted legal uncertainties in relation to the new principle in EMIR REFIT that clearing members must provide access to clearing to their clients on fair, reasonable and non-and transparent discriminatory terms ("FRANDT Principle" or "FRANDT"). The aim of this legal requirement is to improve access to clearing for smaller clients and to incentivise and facilitate access to clearing. Thomas observed that it is broadly drafted in the Regulation. He explained that technical standards will be issued under which the FRANDT requirement will be detailed further. He observed that, depending on how it is interpreted, there are arguments that the FRANDT requirement will be difficult to meet for banks offering options of individual versus omnibus segregation, collateral transformation, security versus title transfer collateral and other options to clients or price differentials between clients of different volume or risk characteristics. Although volume based and optional criteria should be acceptable for price differentials, the large number of options involved in clearing means that disclosures may at least be very complex or multi-faceted.

Moreover, questions arise, based on similar principles applicable to pharmaceuticals, clearing houses and benchmarks, about whether clearing member firms will need to deal in future on a standard terms basis, which could reduce client service. Since the FRANDT principles have not previously been applied to similar type situations in the E.U. law, there is considerable uncertainty as to whether the strict legal interpretation applicable in unrelated fields can be read across to clearing services provided by banks and brokers. Thomas said many in industry think not and he reported that regulators and the Commission have made speeches suggesting otherwise.

3.3. The Chair and other members were of the opinion that the application of the FRANDT requirement could give rise to questions of legal uncertainty.

4. Libor transition issues in the loan market (Bruce Johnston)

4.1. Bruce Johnston, as guest speaker, presented introductory remarks on Libor transition issues in the loan market. He pointed out that once the Financial Conduct Authority ("FCA") has withdrawn support in the form of compelling submitters to participate, it is foreseeable that Libor would feel to meet the adequacy test in the Benchmarks Regulation (i.e. regarding representing the underlying market). He observed that it is not clear as yet how market participants will implement solutions for the demise of Libor. He explained that the Loan Market Association ("LMA") has updated their language, in relation to when fall-backs will be triggered, but still has not decided what the new fall-backs should be. He referred to fall-backs clauses as a waterfall of failure options and briefly raise the question whether the doctrine of frustration might play a role in circumstances of permanent benchmark withdrawal.

4.2. Mr. Johnston also mentioned that, at the end of the fall-back waterfall, a market disruption would cause banks to declare the costs of funds, which are higher than Libor and therefore, in theory, more profitable for the lender. On a market-wide basis, this could create economic discontinuity.

4.3. He also noted the LMA documentation was not drafted to Libor discontinuance, but only for market disruption. Difficulties have been encountered in attempting to update benchmark definitions in bond market standard terms documentation, particularly with regard to legacy issuance.

4.4. Bruce discussed the example of an inter-company loan referencing LIBOR. He mused whether the withdrawal of LIBOR would constitute a frustrating event or whether the

publication of a fixed rate on the LIBOR01 screen might successfully avoid that outcome, given the standard contract definition of the benchmark (which refers to the screen rate). The question of contract frustration in the event of benchmark withdrawal, particularly in cases where no fall-backs exist, is a considerable grey area of legal uncertainty in the financial markets. In this regard Bruce also stressed that uncertainty could also lay in a divergence between the international market practice and what the U.S. domestic market might come up doing after the Libor discontinuance. He noted that the Alternative Reference Rates Committee ("ARRC") at the New York Federal Reserve has started recommending the adoption of more robust fall-back language for new originated Libor Syndicated Loans.[1]

4.5. Mr. Johnston stressed the need to focus on drafting new fall-back clauses. This should be tackled independently of the question of any transition from LIBOR to SONIA, as the recommended new Risk Free Rate.

4.6. When the discussion was opened to the forum, one member speculated whether Libor being substituted by risk-free rates wouldn't be creating the next financial crisis, to the extent that bank lending would be at a higher rate than market rates, therefore the needing for central bank lending would increase. Another member wondered whether it was not the right time to organise another seminar on Libor transition at the Bank of England.

5. Plenary discussion on recent developments and legal uncertainties concerning financial market infrastructures (Thomas Donegan) and any other business.

5.1. The chair raised the issue of whether the FMLC would be able to respond to HMT consultation on the UK's EMIR-Refit implementation, asking them to implement the recommendations of the FMLC paper on clearing, drawing attention to the fact that none of the issues for primary legislation referred to in this paper have been taking forward yet. He reported that he had written to the FMLC chair in this regard.

[1] See ARRC Recommends LIBOR Termination Language (2019), available at: https://www.lexology.com/library/detail.aspx?g=11abb794-fe8e-4039-a459-ec7309d9ecd8