LIBOR Transition: Issues of Legal Uncertainty

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1. EXECUTIVE SUMMARY AND INTRODUCTION

1.1. The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2. In June 2012, the U.S. Commodities and Futures Trading Commission issued the first of many penalty notices for efforts to manipulate the London Inter-Bank Offered Rate ("**LIBOR**") and the Euro Interbank Offered Rate ("**EURIBOR**") between 2005 and 2009. The abuse prompted a wholesale review of benchmarks by national and international regulators, including a review of key interbank offered rate ("**IBOR**") benchmarks initiated by an Official Sector Steering Group established by the Financial Stability Board ("**FSB**") in February 2013, which ultimately called for an end to the financial markets' dependency on the IBOR benchmarks. The FSB review culminated in a report, *Reforming Major Interest Rate Benchmarks* (the "**OSSG Report**"), published in July 2014 which concluded that: (1) existing "IBOR" benchmarks and other potential interest reference rates based on unsecured bank funding costs should be strengthened by underpinning them to the greatest extent possible with transaction data; and (2) alternative, nearly risk-free rates ("**RFRs**") should be developed and participants in the derivative markets should be encouraged to use these rates in place of the IBORs.[2] To achieve these objectives, the Report recommended significant changes to the IBORs to anchor the rates more fully in transactions representative of the markets they are supposed to benchmark.

1.3. In 2017, regulators took stock of all that they and market participants had achieved in the field of benchmark reform in the five years since the LIBOR scandal first broke. In so doing, national authorities appeared to acknowledge the insuperability of the challenges facing their attempts to implement the first of the FSB's published recommendations for reform. In July 2017, the FCA announced that it would not guarantee the survival of LIBOR after the end of 2021.[3] While the FCA has confirmed that the issuance of LIBOR referencing cash products should cease at the end of Q3 2020, in light of the significant disruption caused by the pandemic to the transition process for the loan market, the Working Group on Sterling Risk-Free Reference Rates

[2] Financial Stability Board, *Reforming Major Interest Rate Benchmarks,* (22 July 2014), available at: http://www.fsb.org/wp-content/uploads/r_140722.pdf.

[3] See, FCA, "The future of LIBOR": Speech by Andrew Bailey, Chief Executive of the FCA, at Bloomberg London, (27 July 2017), available at: https://www.fca.org.uk/news/speeches/the-future-of-libor.

("**RFRWG**"), an industry-led working group which also comprises ex-officio members from the FCA and the Bank of England, issued a statement on 29 April 2020, extending the recommended deadline for LIBOR-referencing loans.[4] It included the following provisos:

a) by the end of Q3 2020, lenders should be in a position to offer non-LIBOR linked loans;

b) from the beginning of Q4 2020, lenders should include clear contractual arrangements to facilitate conversion before the end of 2021; and

c) the issuance of new sterling LIBOR-referencing cash products with a maturity extending beyond 31 December 2021 must cease by the end of Q1 2021.

1.4. Industry groups established by the Bank of England, the Federal Reserve and the Swiss National Bank have each identified a preferred RFR for interest rates payable on transactions in their respective currencies. In April 2017, the RFRWG announced the Sterling Overnight Index Average ("**SONIA**") as its preferred RFR for use in sterling derivatives and relevant financial contracts on the back of reforms to the methodology announced earlier by the Bank of England.[5] The Federal Reserve's Alternative Reference Rates Committee ("**ARRC**") selected the Secured Overnight Financing Rate ("**SOFR**") as its preferred alternative reference rate and the National Working Group on Swiss franc reference rates, established by the Swiss National Bank, recommended the Swiss Average Rate Overnight ("**SARON**") as an alternative benchmark to Swiss franc LIBOR. Since the announcement, the transition from LIBOR to SONIA, SOFR and other chosen risk-free rates has occupied the derivatives, securities and loan markets, although no successor rate has been adopted on a market-wide basis yet and market engagement around the question of establishing term rates has proven particularly challenging. Given the volume of contracts and transactions which reference LIBOR, the discontinuation of the rate is likely to have an immense impact on many firms' existing back books, and stakeholders have raised with the Committee the question of how these complexities may be resolved to ensure legal and operational certainty in the wholesale financial markets.

[4] FCA and RFRWG, *Further statement from the RFRWG on the impact of Coronavirus on the timeline for firms' LIBOR transition plans*, (29 April 2020), available at: https://www.fca.org.uk/news/statements/further-statement-rfrwg-impact-coronavirus-timeline-firms-libor-transition-plans

[5] Bank of England, Press Release: SONIA recommended as the sterling near risk-free interest rate benchmark, (28 April 2017), available at: https://www.bankofengland.co.uk/news/2017/april/sonia-recommended-as-the-sterling-near-risk-free-interest-rate-benchmark.

1.5. The FMLC has taken great interest in and published prolifically on issues relating to benchmark reform, benchmark transition, LIBOR and SONIA, even before the 2017 announcement.[6] This paper, although a departure from the Committee's usual approach, is intended to survey the uncertainties in the context of LIBOR transition and the steps being taken by authorities around the world so as to draw attention to any residual issues. To that end, section 2, below, comprises a brief overview of the Committee's views as to the risks arising in respect of benchmark reform and, specifically, from the transition from LIBOR. Section 3 comprises analysis of uncertainties arising from the U.K.'s impending withdrawal from the E.U. and the complexities it adds to the adoption of a successor rate. Section 4 offers a survey of the specific ways in which it may be possible to mitigate the legal uncertainties in this context—including by legislative, regulatory or market action. In examining each option, the FMLC has drawn out the strengths and weaknesses and attempted to present a thorough-going, impartial and publicly accessible account.

2. ISSUES OF LEGAL UNCERTAINTY

2.1. The market transition pathway from LIBOR to SONIA and other RFRs has been considered to differing degrees by the working groups established by the various central banks concerned. The question of implementation pathways for benchmark transition has also been addressed, in abstract, as part of a report by a Market Participants Group (the "**MPG Report**") supporting work by the FSB.[7] Broadly, the MPG Report considers four alternative transition pathways: (i) a "seamless transition", according to which an existing benchmark transitions from one methodology to another;[8] (ii) a "successor rate" pathway, whereby one benchmark is withdrawn and replaced by another with a different but similar identity; (iii) a "market-led" transition, involving the gradual, voluntary adoption of a different benchmark published in parallel to the legacy benchmark; and (iv) a "cutover" transition, whereby adoption of a new benchmark is encouraged by notice to users that, after a finite parallel run, the legacy benchmark will be withdrawn at a future date. The transition from an IBOR benchmark to an RFR must necessarily fall into one of the latter three categories, since the whole premise of

[6] For an overview of the FMLC's work, please see http://fmlc.org/libor-transition/.

[7] *Final Report: Market Participants Group on Reforming Interest Rate Benchmarks*, (March 2014), available at: https://www.fsb.org/wp-content/uploads/r_140722b.pdf.

[8] By the time the FSB Report was published, the first of these pathways was commonly referred to as "evolution" rather than "transition", because it involves no material shift in the identity of the benchmark.

the exercise is that the alternative rate is fundamentally different from the original. Although the pathway contemplated by central banks and their working groups is not yet fully crystallised, it seems likely that it will involve a period of "market-led" transition, which may, in some cases, be followed by the withdrawal of the IBOR and a hard "cut over" with one possible exception, discussed below at paragraphs 4.4 to 4.6.

2.2. If LIBOR cannot be sustained after 2021, it is the transfer of legacy contracts to the nominated alternative rate, rather than new ones, which is likely to give rise to the most significant economic and legal questions. The withdrawal of the old benchmark—with or without the introduction of a new one—may have the effect of defeating the parties' primary expectations as those were settled at the outset of the contract, giving rise to the risk of contract frustration.[9] It may be said that benchmark disruption or withdrawal would present a risk of frustration for some contracts and, occasionally, the same thing is said of benchmark transition or even of radical benchmark evolution—on the premise that the evolved benchmark no longer shares the identity of the original benchmark. Significantly, a contract will not be held by a court to have been frustrated, however, wherever the contract is drafted so as expressly or impliedly to allocate the risks of the allegedly frustrating event as between the parties. This is exactly what most financial markets contracts on market standard terms aim to achieve with clauses that provide for fallback arrangements ("**fallback clauses**")—for example, rate-setting by a nominated calculation agent—in the event of benchmark withdrawal. Some contracts include clauses which provide for their termination in the event of "force majeure" or impossibility. Parties may seek to argue that benchmark withdrawal renders performance of the contract impossible and that their obligation to perform the contract is discharged as a result. Many contain the "fallback" clauses mentioned above but these—which typically refer to bespoke arrangements for rate-setting by the lender or agents of the parties—may be cumbersome to apply on a daily basis and, having been designed to operate during a break in the continuity of benchmark provision, may prove disruptive to apply on a market wide and permanent basis.

2.3. Another obvious issue is that fixings for the IBOR benchmarks are produced in multiple tenors, or maturities. LIBOR, for example, in addition to being an overnight rate, is a term rate produced in maturities of one week, one month, two months, three months, six months and 12 months. The input data in each case is transactions of the relevant maturity. Thus, the LIBOR six month daily fixing is calculated—subject to the availability of transaction data—on the basis of funding transactions between banks

[9] This risk materialises when the subject matter of a contract has been destroyed, or has otherwise become unavailable, and as a consequence the performance of the contract by one or both parties is rendered impossible.

with a maturity of six months. The view of the RFRWG, which was published in a paper on the use cases of benchmark rates in January 2020, is that in most markets where instruments might once have referenced a forward-looking term LIBOR tenor, new contracts should reference an RFR, like SONIA, compounded in arrears over the life of the contract.[10]

2.4. By definition, however, an overnight rate will always be calculated on the basis of overnight transactions and that means the rate, even after compounding, will be economically different than a rate calculated on the basis of transactions with greater maturity (which carry greater credit exposure and opportunity cost. The effect of this divergence between LIBOR term rates and contractual rates tied to the RFR is predominantly a market one in the case of new contracts and a legal and operational one in the case of legacy contracts but at the heart of both issues is the question of what credit spread or other adjustments will be introduced in order to reduce the divergence between LIBOR term rates and the RFR. In the paper on use cases referred to above, the RFRWG recommended the development of a "TSRR" or Term SONIA Reference Rate which could be used in certain markets which would be difficult to transition to compounded overnight rates. Four data companies were subsequently mandated to produce a TSRR for testing over a six month period and further scrutiny by the RFRWG.[11]

2.5. One consideration which will doubtless weigh with market participants in considering how to transition new wholesale derivatives business is that the collateral which provides security for swaps deals generally attracts interest at the relevant overnight accommodation rate (i.e. at the relevant RFR), a fact which has already led to the use of OIS rate discount curves in pricing swaps. The issues for legacy derivatives contracts, however, are more complicated. As with all legacy instruments, the parties to these contracts had settled economic expectations at the point of their agreement and replacing LIBOR with an RFR in their contract during its term would confound their plans. These are circumstances in which ordinarily it might be appropriate for parties to bring an end to their contract under a negotiated settlement but in this context that would probably be disruptive (given the volume of contracts referencing LIBOR) and certainly onerous. Equally onerous would be a piecemeal effort to transition legacy

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[10] See, *Use Cases of Benchmark Rates: Compounded in Arrears, Term Rate and Further Alternatives* (Bank of England, January 2020), available at: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/use-cases-of-benchmark-rates-compounded-in-arrears-term-rate-and-further-alternatives.pdf

[11] Ibid.

contracts one-by-one onto such new substitute term rates or compounded rates as may appeal to the parties—an approach which would be highly likely to introduce both basis and legal risk in relation to back-to-back contracts. This problem is not new. A similar issue arose in relation to currency transition when the single currency was introduced. Legacy contracts had to incorporate the new currency (Euros) or be satisfactorily resolved in some other way when the old European currencies were withdrawn and legislation was introduced to achieve just this result and to safeguard against the possibility of contracts coming to a disorderly conclusion under legal doctrines like *force majeure* or frustration.

2.6. On 23 June 2020, the Chancellor of the Exchequer made a statement in which he recognised the impediment to preparing from LIBOR transition caused by the COVID-19 pandemic but reiterated that firms would be unable to rely on the continued publication of LIBOR after the end of 2021.[12] The Chancellor encouraged firms to continue planning actively to transition their contracts away from LIBOR and announced the following steps by way of legislation which would help the small pool of "tough legacy" contracts for which transition was more tricky:[13]

- To ensure that the FCA's powers are sufficient to manage an orderly transition from LIBOR, further amendments will be introduced to the legislative framework governing financial benchmarks in the U.K by means of a new Financial Services Bill. The pre-existing framework comprises Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the "**BMR**") which was brought onshore and amended by the Benchmarks (Amendment) (EU Exit) Regulations 2018 (together the "**U.K. BMR**") under the European Union (Withdrawal) Act 2018 so as to make adjustments to the BMR for the purposes of Brexit (see below),

- An extension will be provided to the circumstances in which the FCA may require an administrator to change the methodology of a critical benchmark along with clarification of the purpose for which the FCA may exercise this power;

[12] Rishi Sunak (The Chancellor of the Exchequer), *Financial Services Regulation: Written statement - HCWS307,* (23 June 2020), available at: https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-06-23/HCWS307/

[13] An indication of which legacy contracts will fall within the category of "tough" can be taken from the recommendations put forward by the RFRWG in its report published in May 2020. See: Working Group on Sterling Risk-Free Reference Rates, Paper on the Identification of Tough Legacy Issues, (May 2020), available at: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/paper-on-the-identification-of-tough-legacy-issues.pdf

- Existing law will be strengthened to prohibit the use of an individual critical benchmark where its representativeness will not be restored, whilst giving the regulator the ability to specify limited continued use in legacy contracts; and

- Ancillary areas of the U.K.'s regulatory framework will be refined for benchmarks to ensure their effectiveness in managing the orderly wind down of a critical benchmark, including that administrators have adequate plans in place for such situations.

The legislation will empower the FCA to help those who cannot amend their contracts by directing the administrator of LIBOR—Ice Benchmark Administration ("**IBA**")—to change the methodology used to compile the benchmark, creating a so-called "**Transition LIBOR**". A statement published by the FCA immediately following the Chancellor's announcement notes that this will allow the FCA to stabilise certain LIBOR rates during a wind-down period so that limited use in legacy contracts could continue.[14] The FCA has said it will publish policy statements on its approach to the potential use of these powers in due course.

2.7. While the announcement has been welcomed by many market participants, several complexities remain. In addition to the economic and mathematical challenges of developing a Transition LIBOR, one of the issues that will arise in this scenario is the extent to which market participants can rely on the index beyond a wind-down period and/or beyond the limited range of "tough legacy" contracts highlighted by the FCA. Another question is whether the new methodology will resemble: 1) "synthetic LIBOR" a concept which has long been discussed by market participants and which usually takes the form (for the purposes of discussion) of an RFR like SONIA plus a fixed (or, possibly, floating) margin to reflect a credit component; 2) a new RFR term rate; 3) or an index which fixes values representing an RFR compounded in arrears. The FCA has pointed out that a range of different approaches to transition and replacement rates has already emerged for different market segments and it is not possible to satisfy all preferences at once.[15] Even if the bulk of the market moves to overnight RFRs compounded in arrears, this transition "may not be possible to replicate within the restrictions of the existing LIBOR framework". In any event, concerns about deviating from parties' settled economic expectations will arise for legacy contracts even

[14] FCA, *Statement on planned amendments to the Benchmarks Regulation*, (23 June 2020), available at: https://www.fca.org.uk/news/statements/fca-statement-planned-amendments-benchmarks-regulation

[15] *Ibid*

in the context of a Transition LIBOR. In a recent speech Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA, pointed out that methodology used to emulate the forward-looking nature of LIBOR in creating a synthetic LIBOR, which would necessarily rely on an historical, backward-looking fixed spread, would not deliver the best option for many market participants, especially parties to derivative and bond contracts. These parties would therefore "be giving up their control over the economics of their contracts."[16] In addition, mandating a "synthetic" LIBOR for legacy contracts by means of the Transition LIBOR without some kind of opt-out for users would likely prove contentious and could lead to risks of contractual uncertainty, with consequential market disruption. A final question in this context relates to whether amendments needed to enable the transition would give rise to other regulatory obligations[17]. Market participants have reached the consensus that LIBOR transition amendments should not be considered to trigger such consequences but regulatory clarity would be helpful.

2.8. One possibility not addressed by the FCA in this statement, was the idea that Transition LIBOR might, for Sterling, replicate the TSRR that is expected to emerge from the beta testing process. On balance this seems unlikely in most cases because it would involve the data firm in question making its data or product available to IBA but one of the competitors in the race to produce a TSRR is IBA itself, which is also working to produce a term dollar RFR. There must therefore be a concern that IBA has an advantage in the race, given that it alone can produce a synthetic LIBOR for the purposes of the new legislation.

2.9. The FCA did, however, stress that any given methodology change may prove to be impracticable or insufficiently protective of consumers or market integrity. As to practicability, there is inevitably a set of issues the FCA would face in exercising its powers under the legislation around the problem of convergence and/or divergence between the value of tough legacy contracts moving onto Transition LIBOR and both the projected value of the contract under the discontinued LIBOR and the value of similar products in the wider market, which may have moved to a compounded RFR, an RFR plus a floating credit spread adjustment or a new term RFR. In any event, said the regulator, a majority of contracts will need to be transitioned away from LIBOR.

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16 Edwin Schooling Latter, Speech: "LIBOR transition – the critical tasks ahead of us in the second half of 2020", (3 August 2020), available at: https://www.fca.org.uk/news/speeches/libor-transition-critical-tasks-ahead-us-second-half-2020

17 For example, market participants have questioned whether such an amendment would constitute a reportable amendment under Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories ("EMIR").

2.10. Against this background, the FMLC has analysed a range of options which, in part individually or in conjunction, may help ensure a smooth resolution or transition of the bulk of legacy contracts away from LIBOR. None of these options is a panacea: section 4 below provides an overview of each of these paths.

3. THE U.K.'S WITHDRAWAL FROM THE E.U.

3.1. Any discussion of the financial markets in and after 2021 would be incomplete without at least a brief consideration of the possible consequences of the U.K.'s withdrawal from the E.U. The U.K. ceased to be an E.U. Member State on 31 January 2020 when it entered, under the Withdrawal Agreement negotiated between the U.K. and E.U., a transitional or "implementation" period. During this period, the U.K. will continue to comply with and implement E.U. law. The implementation period ends on 31 December 2020, after which the U.K.'s relationship with the E.U. will be governed either by the provisions of a Free Trade Agreement, if one has been agreed, or by the World Trade Organization's rules. In the latter case, financial services in the U.K. will be governed by retained E.U. law, as amended over the past two years by pieces of "onshoring" legislation.

3.2. E.U. legislation which comes into effect after the end of the Brexit Transition Period will not be onshored in the U.K. This includes legislative steps being considered in the E.U. to mitigate uncertainties in the context of LIBOR transition. In July 2020, the European Commission published a proposal for a regulation to amend the BMR so as to facilitate the exemption of certain Third Country foreign exchange benchmarks and the designation of replacement benchmarks (the "**BMR Amendment Proposal**").[18] The BMR Amendment Proposal states that, in view of the concerns arising in the context of the cessation of LIBOR, and given the difficulties which may arise in amending existing contracts to reflect replacement rates, a reform of the BMR is necessary to establish a statutory replacement rate. The BMR Amendment Proposal gives the European Commission the power to designate a statutory successor for a benchmark whose cessation would result in significant disruption in the functioning of financial markets in the Union. The successor rate will be incorporated, by operation of law, into contracts involving E.U. supervised entities, as Recital 7 and Article 23(a)(2) make clear in

[18] European Commission, Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation (24 July 2020), available at: https://ec.europa.eu/finance/docs/law/200724-benchmarks-review-proposal_en.pdf

combination. On 7 October, the European Council published its position on the BMR Amendment Proposal, taking the view that the proposed powers should apply to a broader range of contracts and financial instruments that reference a benchmark, including both financial contracts and instruments that are subject to the law of an E.U. Member State and certain Third Countries.[19] The proposal is yet to be considered by the European Parliament. It is unlikely that it will be "operative" for the purposes of the European Union (Withdrawal) Act 2018 before the end of the Brexit Transition Period and it will therefore not be automatically "onshored" in the U.K. U.K. supervised entities will not be subject to this regime, except in so far as they are party to contracts to contracts with E.U. supervised entities.

3.3. One issue of concern in relation to these proposals is how they will interact with the proposed U.K. Financial Services Bill which may result in a "synthetic LIBOR". It is at least possible that LIBOR might both have been discontinued—for the purposes of the amended BMR, triggering the EU Commission's power to designate a replacement rate—and preserved in the sense that IBA has been required by the FCA to produce a synthetic benchmark for publication on LIBOR publication venues. Given that other jurisdictions, including New York, are also considering legislation to incorporate a successor rate by operation of law into contracts, where they are governed by local law, the problem of potential conflict and overlap is a pressing one.[20] The challenge for regulators will be one of careful coordination.

3.4. In any event, the U.K. will be, for the purposes of the E.U. BMR, a Third Country. This may have implications for any plans to establish a new rate to replace LIBOR in the U.K., which will be, for the E.U. market, a Third Country benchmark. For this purpose, it is important to consider transition plans across the range LIBOR currencies—Yen, Sterling, Euro, U.S. Dollar and Swiss Franc. Work on successor rates to the various LIBOR currency benchmarks has largely been "re-homed" to the jurisdictions and/or regions in which the relevant currencies are sovereign legal tender. It is, however, also possible that additional "offshore" rates will be adopted for some purposes. This suggests that any Sterling LIBOR successor rate and any putative

[19] Council of the European Union, Proposal for a Regulation Of The European Parliament And Of The Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in Cessation - Mandate for negotiations with the European Parliament, available at: https://data.consilium.europa.eu/doc/document/ST-11049-2020-ADD-1-REV-1/en/pdf

[20] See *ARRC Executive Summary of Proposed Legislative Solution to LIBOR Transition*, (NY, 6 March 2020) available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Proposed-Legislative-Solution.pdf and *ARRC Proposed Legislative Solution Press Release*, (NY, 6 March 2020), available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_Proposed_Legislative_Solution.pdf

London-based offshore USD LIBOR successor rate would be Third Country benchmarks for the purposes of European regulation. The FMLC has set out in papers in the past the challenges facing a new Third County benchmark administrator which wishes to provide its benchmark to E.U. financial institutions under the BMR.[21] (It should, however, be noted that those challenges are likely to be greatly reduced in the case of benchmarks—like SONIA—provided by central banks, which benefit from an exemption under the BMR.[22])

3.5. The Brexit process also has implications for the provision of new successor rates to U.K. supervised entities by administrators based outside the U.K. The onshoring process has resulted in a statutory instrument which largely reflects the terms of the BMR, adapted to the British context. In conjunction with the "re-homing" process noted in the paragraph above, this means that the successor rates to Yen, Euro, Swiss Franc and Dollar LIBOR will be Third Country rates as far as U.K. law is concerned. This could result in challenges for both the Third Country administrators and the U.K. supervised entities wishing to rely on those benchmarks—particularly in cases where the Brexit implementation period expires before the successor rate is widely adopted in the market—although, again, these challenges will be significantly reduced, if not altogether eliminated, in the case of central bank administered rates.[23] In recognition of these challenges, the Chancellor announced that legislation would be published in due course which would amend the U.K. BMR to ensure continued market access to Third Country benchmarks until end-2025.[24]

3.6. Brexit raises other concerns too. HM Government's legislative priorities are likely to be readying the country for withdrawal from the E.U.—and now recovery from the pandemic—which means that authorities are unlikely to be able to provide the requisite level of review and oversight to any new legislation. Market participants, already

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21 See, for example, FMLC, *Report: Brexit Analysis on Third Country Regimes in E.U. Legislation*, (13 July 2017), available at: http://fmlc.org/report-u-k-withdrawal-from-the-e-u-13-july-2017/.

22 Note, however, that the TSRR discussed in paragraphs 2.4 and 2.8 above as well as other term rates will not be provided by Central Banks.

23 The BMR permits financial institutions in the E.U. to use only those benchmarks which are registered with the European Securities and Markets Authority ("ESMA"). Administrators of benchmarks in Third Countries have to register their benchmarks with ESMA on the basis of: (i) a positive equivalence decision; (ii) recognition of the Third Country administrator by the competent authority of its "Member State of Reference"; or (iii) endorsement by an E.U. administrator, with full authorisation, of the Third Country benchmark(s). in the absence of registration by one of the three means provided, E.U.-supervised entities will be prevented from using a U.K.-administered benchmark (except for central bank rates to which, as per Article 2, the BMR does not apply) in the E.U.

24 Rishi Sunak (The Chancellor of the Exchequer), *Financial Services Regulation: Written statement - HCWS309*, (23 June 2020), available at: https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-06-23/HCWS309/

occupied with preparing for Brexit, may struggle with the operational burden of repapering contracts at an unprecedented scale (although, one might argue that repapering could address both LIBOR transition and Brexit in one fell swoop).

4. SOLUTIONS AND MITIGANTS

A. Market action—repapering

4.1. Market participants have long anticipated that a large-scale document remediation effort—or repapering—will be necessary in order to transition legacy contracts with a maturity past end-2021 away from LIBOR. This would require market participants to review their portfolios to determine which transactions are affected by the discontinuation of LIBOR and undertake an amendment process for each affected transaction. Whilst repapering presents an operational burden, it provides a high degree of legal certainty. In the event the successor rate has been identified, repapering will provide market participants with contractual certainty; in the event the market and authorities have not coalesced around a specific replacement, stakeholders have suggested that existing documents may be amended to incorporate a supplementary document into the contract, such as, in the derivatives market, the ISDA Benchmarks Supplement (for more on which, see below), which gives parties a contractual mechanism for dealing with the discontinuation of LIBOR.[25] A successful repapering exercise requires a precise understanding of the legal issues and the practical realities of the transition to the new RFRs across different currencies and financial products.

4.2. The amendment process is, however, costly and time consuming. Where negotiations have to be multilateral, such as for syndicated loans where a number of lenders must agree and actors may be motivated to hold-out, or for structures featuring trustees, who typically have a very low risk appetite and may be reluctant to act for fear of litigation, the process is likely to be complicated. The Loan Market Association has published a draft Reference Rate Selection Agreement to help streamline the process of transition to alternative reference rates through the use of the same form of agreement on different

[25] The ISDA Benchmarks Supplement is a document that was published by ISDA on 19 September 2018 to help firms address the requirements in Article 28(2) of the Benchmark Regulation, which requires "supervised entities" that use a benchmark to produce and maintain robust written plans setting out the actions they would take in the event that a benchmark materially changes or ceases to be provided. The Benchmarks Supplement includes a number of trigger events relating to benchmarks and fallback clauses which apply upon the occurrence of one of those triggers.

transactions.[26] The unprecedented scale of repapering needed may lead to execution risk, either because documents can't be agreed or because errors occur.

4.3. Whilst the nature of launching a repapering exercise requires parties to be proactive and act on a settled schedule, firms equally face first-mover disadvantages—i.e., the risk that the broader market will take a different approach—which, in turn, may give rise to conduct risk for firms if their chose replacement rate could prejudice their clients.[27] An additional challenge is presented if the repapering exercise is commenced before the market has settled on a replacement rate. In these circumstances, possible risks to the parties include (without limitation) a mismatch in a chain of back-to-back trades, undermining hedging or liquidity arrangements, and/or moving a trade against the market with the attendant possibility of a spread emerging between assets that are intended to off-set one another.

B. Preserving screen continuity

4.4. One route which would be substantially less onerous from an operational and cost perspective is to amend the feeds on the Bloomberg and Reuters LIBOR01 pages so that a successor rate is displayed instead, under the "LIBOR" rubric. Standard clauses in contracts often include references to the Reuters LIBOR01 page with the definition that this

> "means the display designated as page LIBOR01 on the Reuters 3000 Xtra (or such other page as may replace the Reuters LIBOR01 page on that service, or such other service as may be nominated as the information window, for the purpose of displaying rates or prices comparable to the London Interbank Offered Rate…"

For contracts which refer to the relevant page, this would remove the need for repapering and eliminate the reliance on fallback clauses, both of which give rise to several uncertainties. The Financial Stability Board recommended this as a method by which a "seamless transition" might be achieved, if the successor rate is "similar in

[26] Loan Market Association, Press Release: "LMA publishes exposure draft of reference rate selection agreement for transition of legacy transactions to risk-free rates", (25 October 2019), available at: https://www.lma.eu.com/news-publications/press-releases?id=173

[27] This risk is likely to be greater for retail clients/consumers given the application of more rigorous regulatory conduct of business rules.

definition, value and volatility" to the current IBOR.[28] It should be noted that this approach requires the production of term successor rates to replace the existing LIBOR tenors, in the manner of the planned TSRR. Legislation or some kind of mandate from regulatory authorities might be necessary to permit such a change. In this regard, the proposed Financial Services Bill could facilitate the change by requiring IBA to create a synthetic LIBOR, as discussed above, for publication on the usual venues but this would encounter a number of problems. For example, mandating the use of regulated data or proprietary data owned by another firm in the construction of a term RFR would prima facie confer an unfair commercial advantage on IBA.

4.5. Leaving these difficulties aside, the publication of a successor rate by a trusted administrator in the usual publication venues would increase confidence in the market; shifting the burden of the transition away from market participants. It would encourage the universal adoption of the new rate and reduce the possibility of lags in uptake. The existing LIBOR01 pages provide a screen rate and a calculation tool which is vitally important to enable parties to calculate interest for transactions, given that the rate must be capable of being used in a transparent way to allow lenders and facility agents to calculate interest.

4.6. Substituting the data on the web page may, therefore, be an appropriate mitigation if the rate were close enough in spirit to the original LIBOR.[29] It is likely, in these circumstances, that an English court would either acknowledge the screen page as the cornerstone of the contractual definition or, alternatively, be willing to at least consider an implied term that the contract tracks the new rate.[30]

C. A legislative solution

4.7. One possible mitigant which has received a lot of attention is the introduction of legislation to resolve the problem of legacy contracts. As described above, authorities in

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[28] See section 4.3.1 of FSB Raper (n. 2) above. The Bank of England published a discussion paper on 26 February 2020 outlining the methodology it intends to adopt for calculating the SONIA Compounded Index and proposed policies in relation to the publication of the data. See, Bank of England, *Discussion Paper: Supporting Risk-Free Rate Transition through the Provision of Compounded SONIA*, (February 2020), available at: https://www.bankofengland.co.uk/paper/2020/supporting-risk-free-rate-transition-through-the-provision-of-compounded-sonia.

[29] Stakeholders have commented that this approach has proven effective in practice. Over recent years, LIBOR has been reformed to the point where it is no longer "London"-based, an "interbank" rate or an "offered" rate. It continues, however, to resemble the originally intended economic reality and, in the absence of an alternative, has been accepted by the market. A similar argument could be made with regards to EONIA which is now €STR plus 8.5 basis points.

[30] The FSB considered this in the paper. See p. 43 of FSB Raper (n. 2) above.

the U.K., E.U. and U.S. have all proposed legislative provisions by means of which legacy contracts may be transitioned onto a successor rate—albeit each proposal takes a different approach. The proposed amendments to the E.U. BMR makes provisions to incorporate a new rate into financial instruments by operation of the law, while in New York, for example, the ARRC has proposed legislation that would prohibit a party from refusing to perform its contractual obligations or declaring a breach of contract as a result of LIBOR discontinuance. The proposed legislation would also establish, for the purposes of any dispute, that a recommended benchmark replacement is a commercially reasonable substitute to LIBOR. It would also: override existing fallback language that references a LIBOR-based rate and instead require the use of the legislation's recommended benchmark replacement; nullify existing fallback language regarding reference banks polling; and insert the recommended benchmark replacement as the LIBOR fallback in contracts that do not have any existing fallback language.[31]

4.8. Commentators who advocate this solution often point to the suite of legislation produced by the European Commission to facilitate currency transition, which inevitably involves transition of legacy contracts away from a local currency interest rate onto a Euro-denominated one. This legislative planning has always been regarded as highly successful, guaranteeing a smooth transition for local benchmarks across both civil law and common law (i.e., Irish) jurisdictions.[32] One of the principal objections to such an approach in the case of LIBOR is that, unlike European currency transition, choice of law, choice of currency and the situs of the benchmark are not regionally aligned. U.K. legislation could not, for example, affect the meaning of contractual definitions in New York law governed contracts referencing USD LIBOR. Another objection is that the substantial interference with freedom of contract which the legislation would bring about (a matter occasionally said to raise questions about the putative application of Article 1 Protocol 1 of the Human Rights Act 1998) is less clearly proportionate to the harm foreseen, given, first, that alternative mitigants are available and, second, that benchmark transition arguably falls short of being a public good of the order of magnitude that a smoothly effectuated currency union may be said to be.[33] A third objection is that it is impossible for authorities to take into account every

[31] *Supra, n. 16.*

[32] In May 2020, the Tough Legacy Contracts Taskforce of the RFRWG proposed that HM Government consider legislation to address tough legacy exposures in contracts governed by English law that reference at least sterling LIBOR, and ideally other LIBOR currencies, that are still in operation when LIBOR is expected to cease on or after the end of 2021. See: *Tough Legacy Issues*, at no. 13 above.

[33] See, for example, the litigation arising in relation to recovery and resolution legislation passed in Austria to save the defunct lender Hypo-Alpe Adria Bank.

legal or regulatory consequence which may attach to amendment, leading to unintended consequences. In contrast, the legislative package for currency transition—developed before many complex contractual terms were introduced in the wake of the financial crisis—has been tried and tested over the course of two decades.

4.9. Given these considerations, it will be important to weigh whether legislation, although seemingly adopted by authorities around the world, is indeed likely to provide a perfect solution. Legacy contracts present a range of situations as to the number of parties and the level of their ongoing engagement with the instrument: from high-value, wholesale bespoke loans or bilateral derivatives, on the one hand, to multi-party products aimed at ordinary investors, on the other. The former will usually be easier to renegotiate, repaper and/or settle than the latter, which raises the question whether legislation to override freedom of contract is appropriate for the full range of instruments and circumstances. One approach to consider, therefore, is restricted legislation targeting the tough legacy cases, which is the anticipated scope of the proposed Financial Services Bill referred to above. This approach might incorporate pre-conditions to [re-indexation] such as a requirement that there are multiple parties, parties who cannot be identified, contracts that are linked as part of a broader transaction or that the parties to the contract are not responsive to any amendment requests in the context of contracts with retail counterparties or sponsors that are no longer active. In these circumstances but only in these circumstances, the legislation would enable the successor rate to be substituted in the place of LIBOR.

4.10. Whatever approach is chosen, there may arise issues around which successor rate is adopted. In the absence of legislation, parties to contracts may not necessarily think it best to move every transaction which currently refers to LIBOR to the recommended RFR. The fact that legislation is likely to take a "one-size-fits-all" approach illustrates, therefore, the fact that it is a material—and not merely theoretical—interference with freedom of contract. On the other hand, the ability to ensure a uniform market-wide transition could prove to be a valuable tool in the battle for market stability and a smooth transition, given that it will avoid discrepancies between contractual reference rates in linked contracts.

4.11. It has also been suggested that legislation may help mitigate adverse consequences for customers in the absence or insufficiency of triggers or fallback clauses by preventing

circumstances in which they would produce undesirable economic outcomes.[34] This is broadly the approach adopted by the ARRC-proposed legislation referred to above.

4.12. U.K. legislation could provide a definitive timetable for transition and reduce the possibility of disputes. It would bind U.K. courts, would apply to English law-governed contracts and could create consistency across the market.[35] The legislation might set out the broad principles that the FCA should apply when exercising its power to require a change to the calculation methodology and require the FCA to prepare and consult on guidance providing detail on the circumstances and manner in which the power might be exercised. Legislation would also lift a substantial operational burden from market participants and reduce legal risks that might arise through re-papering mistakes and allegations of misconduct.

4.13. Any legislation, as seen from the E.U. and U.S. proposals discussed above, is, however, likely to be a complex undertaking, particularly given the range of agreements which would have to be covered by it, which gives rise to the risk that the legislation is either too ambiguous or is overly prescriptive, leading to unintended consequences. In the U.K., specifically, concerns also arise regarding the timing of any legislation which, in an ideal scenario, would be preceded by a consultation period and which would compete with Brexit and pandemic-related legislation for Parliamentary time and attention.

D. An extension of LIBOR beyond 2021 for legacy instruments

4.14. The uncertainty around legacy contracts may be mitigated if it were agreed that LIBOR would be made available for use in legacy instruments even though it may not be compliant with the BMR. In order to mitigate the impact of a failure by benchmark providers to secure recognition at the date of the application of the BMR, the Regulation also includes transitional provisions in Article 51, the first of which is a two-year grandfathering or grace period (the "**Article 51 transitional period**"), following the entry into application of the BMR in January 2018. Regulation (EU) 2019/2089 as regards EU climate transition benchmarks, EU Paris aligned benchmarks and sustainability -related disclosures for benchmarks (the "**Low Carbon Benchmarks**

[34] For example, fallback clauses may refer to another IBOR, produce commercially undesirable outcomes (perhaps by reference to last-quoted IBOR, converting the variable rate into a fixed rate), lead to a value transfer or otherwise change the performance of the contract in an unforeseeable manner, or may be different in linked products (such as a cash product and a hedge) giving rise to tax or accounting complications.

[35] The FMLC has written elsewhere about the conflict of law issues which may arise in a world in which legislation is also being developed in other jurisdictions. See paragraph 3.3 above and FMLC, Response to Consultation: Proposal to Amend the Benchmarks Regulation, 6 October 2020), available at: http://fmlc.org/response-to-consultation-proposal-to-amend-the-benchmarks-regulation-6-october-2020/

Regulation"), which came into force on 10 December 2019, allowed index providers and financial instruments to continue to use critical benchmarks which do not meet the requirements of the BMR until 31 December 2021. The date has now been regarded by market participants and the relevant authorities as a hard end date.

4.15. There remains the possibility that IBA, which produces LIBOR based on submissions from contributor banks, may continue to calculate an index based on the traditional LIBOR methodology for limited use in legacy contracts. Indeed, IBA has stated that it has considered the continued publication of certain widely-used LIBOR settings after end-2021, if necessary to provide a 'safety-net' for users with outstanding LIBOR-linked contracts that are impossible or impractical to modify.[36] To that end, IBA conducted a survey open to all users of LIBOR. There is no confirmation yet about whether IBA will continue to publish certain LIBOR settings. While IBA acknowledges that any continued publication will have to comply with relevant regulations, it remains uncertain whether the FCA, or equivalent regulators in other jurisdictions, would support the publication of such a legacy-only LIBOR and how the identity of this benchmark would correlate to Transition LIBOR.

4.16. Article 54(2) of the BMR provides the European Commission with the ability to further extend the Article 51 transitional period by 24 months. The European Commission published an Inception Impact Assessment for the BMR in March 2020, which contemplates a possibility of amendments to the Level I text of the BMR to equip competent authorities with supervisory powers to ensure the orderly cessation of a critical benchmark, including the power to mandate its continued provision using a different methodology.[37] It is possible that the European Commission uses this power to support the publication of a legacy-only LIBOR.

4.17. Many market participants believe that an extension would be the easiest and most satisfactory solution to the problem of tough legacy transactions which permeate many areas of the wholesale financial markets. An extension would reduce cliff-edge risks, decrease infrastructure costs, such as the money and time required to read paper contracts, and smooth the process of transition.

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[36] ICE, *LIBOR: The Future of LIBOR*, available at: https://www.theice.com/iba/libor

[37] European Commission, Financial benchmarks (for interest rates, stock-exchange prices, exchange rates, etc.) – review of EU rules (18 March 2020), available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12268-Review-of-the-Benchmark-Regulation-

4.18. The solution presupposes, however, that LIBOR can be kept going. In a speech delivered in July 2019, Andrew Bailey, then the Chief Executive of the FCA, stated that he could offer "no certainty to those who have not taken steps to move off LIBOR by end-2021."[38] Then in March of this year the FCA and Bank of England wrote jointly to trade associations to say that the period to end-2021 "will give users time to switch to alternative rates before LIBOR is discontinued".[39] The use of the word "discontinued" is new and suggests LIBOR has a hard cut-off date. The Chancellor's statement in June regarding legislation for tough legacy contracts was also arguably inconsistent with the continuation of LIBOR as it is currently calculated in that it contemplates the exercise of a power to require IBA to adopt a new methodology and a "Transition LIBOR in place of the old one. Nevertheless, given the complexities arising from the Covid-19 pandemic and Brexit-delated delays, the prospect of an extension has received market support.

E. <u>Mandating a specific successor rate within a set timeframe</u>

4.19. Much of the uncertainty arising in the context of the discontinuation of, and transition away from, LIBOR had its root in the lack of specific information available with regards to the successor rate and it was thought that one way by which the uncertainty might be mitigated by market authorities is by issuing strong guidance designating a specified successor rate. It was hoped that a strongly worded statement of this kind would compel the market to transition contracts away from LIBOR and build volume in respect of the successor rate. The actions taken by authorities in the U.K., E.U. and U.S. in respect of foreshadowing legislation to incorporate a successor rate or a new fallback into contracts or to compel a methodological transition (as described above) may be considered a "strong" version of this solution. It is, however, as yet unclear which of these proposals will be not only enacted but also implemented in practice, which rate will be identified when implementation occurs and how the various proposals will interact in the case of cross-border border legacy contracts. This lack of clarity about the future continues to give market participants cause for concern.[40] The concerns relate, in particular, to potential conflict and overlap between measures proposed by various jurisdictions. Some of these have been addressed by the FMLC in

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38 Andrew Bailey, Speech on "LIBOR: preparing for the end", (15 July 2019), available at www.fca.org.uk/news/speeches/libor-preparing-end.

39 Letter available at: https://www.bankofengland.co.uk/letter/2020/next-steps-on-libor-transition-letter-to-trade-associations

40 See FMLC's Response to Consultation on amending the Benchmarks Regulation (*supra*, n. 35)

a letter to the European Commission in relation to its proposed amendment to the BMR, making provisions to incorporate a new rate into financial instruments by operation of the law. The FMLC highlighted the potential for difficulties created by the differences in the legislative approaches taken by authorities in different jurisdictions in relation to contracts between U.K. and E.U. entities.[41] For example, "LIBOR" could be theoretically extant under English law as a screen rate but "in cessation" as a methodology and/or as a measure of London interbank unsecured lending rates and therefore replaceable by the statutory replacement rate ("**SRR**") under the proposed E.U. regime. In the case of cross-border contracts, the question of what the terms of the contract mean should be decided according to governing law of the contract, which entails that the SRR will not be automatically incorporated into a contract with an E.U. supervised entity where that contract is governed by English law and that may cause a surprising and possibly chaotic result as far as the entity itself is concerned. Moreover, since the Legislative Proposal does not explain how "by operation of law" is to be interpreted, there may be some confusion as to whether the provisions impliedly derogate from the choice of law rules in Article 12 of Regulation (EC) No 593/2008 on the law applicable to contractual obligations (the "**Rome I Regulation**"), which provide that the interpretation and performance of a contract is governed by its applicable law. Contracts involving E.U. entities with overseas elements could, in theory, be subject to competing interpretations as to which floating price can be strongly supported (Transition LIBOR, as established under the Financial Services Bill, or the SRR), leading to confusion and possible litigation. This concern is exacerbated for market participants by the fact that other jurisdictions, including, for example New York, have proposed a different legislative approach (discussed above). Problems which affect multi-jurisdictional contracts will only be solved through international cooperation.

4.20. In any event, incorporating a successor or fallback rate by operation of law does not address the problem that LIBOR appealed to contracting parties across financial sectors in a way that any proposed alternative appears unlikely to do. The markets that must transition represent a number of different types of products, with different regulatory risks and individual maturity profiles. For example, in some situations, borrowers will want a rate that can be matched to interest periods whereas trading desks may be more focused on the overnight rate. In addition, it may not be appropriate for every

[41] *Ibid*

transaction which refers to LIBOR to move to the mandated RFR for that LIBOR currency. The RFRWG has identified this issue in its analysis on alternative rates.[42]

4.21. This may explain why a number of different solutions remain on the table and are gaining transaction in different use cases, including: synthetic LIBOR with a fixed or floating spread, RFR rates compounded in arrears, and a new forward-looking term RFR rate. In respect of legacy contracts, however, the prospect of contracts moving to different rates across currencies, products and instruments theoretically introduces a risk of disrupting cash flows and global hedges.

F. Market action—protocols and other contractual arrangements

4.22. Parties have also considered including contractual provisions in their agreements to deal with the discontinuation of LIBOR, which has led to the development of market protocols and standard contractual arrangements. As mentioned above, ISDA published in September 2018 the Benchmarks Supplement which deals with the discontinuation of a Relevant Benchmark (including LIBOR).[43] The Benchmarks Supplement can be incorporated using the ISDA 2018 Benchmarks Supplement Protocol. ISDA also plans to amend certain 'floating rate options' in the 2006 ISDA Definitions to include fallbacks that would apply upon the permanent discontinuation of certain key IBORs and upon a "non-representative" determination for LIBOR. For this purpose, ISDA has published a Supplement to the 2006 ISDA Definitions to amend the 2006 ISDA Definitions (the "**Fallback Supplement**").[44]

4.23. ISDA has also published a protocol (or protocols) to facilitate multilateral amendments to include the amended floating rate options, and therefore the fallbacks, in legacy derivative contracts. (the "**Fallbacks Protocol**"). A protocol is a multilateral contractual amendment mechanism used to make standard amendments to ISDA documentation among adhering counterparties. The Benchmarks Supplement complements the Fallbacks Protocol, as it enables firms to agree interim fallback

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[42] See the Webpage at (n. 5) above.

[43] ISDA, *Press Release: ISDA publishes Benchmark Supplement*, (19 September 2018), available at: https://www.isda.org/2018/09/19/isda-publishes-benchmarks-supplement/.

[44] ISDA, *Amendments to the 2006 ISDA Definitions to include new IBOR fallbacks: Supplement number 70 to the 2006 ISDA Definitions*, available at: http://assets.isda.org/media/3062e7b4/23aa1658-pdf/ Upon publication of the Supplement for the relevant IBOR, transactions incorporating the 2006 ISDA Definitions that are entered into on or after the date of the Supplement (i.e., the date that the 2006 ISDA Definitions are amended) will include the amended floating rate option (i.e., the floating rate option with the fallback). Transactions entered into prior to the date of the Supplement (so called "legacy derivative contracts") will continue to be based on the 2006 ISDA Definitions as they existed before they were amended pursuant to the Supplement, and therefore will not include the amended floating rate option with the fallback.

arrangements should an IBOR cease to exist before the IBOR fallbacks are implemented. The IBOR fallbacks will take precedence for specified IBORs once implemented. Both the Fallbacks Supplement and the Fallback Protocol were launched on 9 October 2020, with the changes coming into effect on January 25, 2021.[45] Equally, the Loan Market Association (the "**LMA**") has published an exposure draft multicurrency term and revolving facilities agreement incorporating rate switch provisions, based on the recommendation of the RFRWG that, after the end of Quarter 3 2020, lenders, working with their borrowers, should include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion ahead of end-2021. [46]

4.24. Protocols and standard contractual arrangements are considered to be key in effecting a smooth transition and helping banks move to the successor rates. Such arrangements will help address a large proportion of contracts and provide a definitive timetable. Although the effectiveness of the ISDA IBOR Fallbacks Protocol with respect to any non-ISDA documents has not been as thoroughly investigated, the protocol will be cast to allow other non-ISDA documents to apply it, if given approval by their relevant local sponsoring body, offering a convenient and scaleable solution for mass document changes whilst leaving flexibility to exclude transactions for which, for whatever reason, the protocol solution is inappropriate. Protocols provide an efficient way of implementing industry standard contractual changes to legacy trades with a large number of counterparties, avoiding the need to negotiate bilaterally the same amendments with each party individually. Such a market-based solution is likely to be quicker and more flexible than a legislative solution.

4.25. Protocols are not, however, an absolute panacea. Neither the Fallbacks Protocol nor the Benchmarks Supplement is intended to be a primary means of moving from IBORs to RFRs. Once the fallbacks are in place, it is recommended that market participants focus on voluntary transition before the cessation of any key IBOR. They may only work for bilateral transactions and are currently only available in respect of derivative documents. Protocols will not mitigate uncertainty in respect of linked transactions—i.e., a loan and swap—as they need to transition at the same time and in respect of asset classes with less standardised documentation. The present uncertainty regarding the

45 ISDA, *Press Release: ISDA Launches IBOR Fallbacks Supplement and Protocol* (9 October 2020), available at: https://www.isda.org/2020/10/23/isda-launches-ibor-fallbacks-supplement-and-protocol/.

46 LMA, *Press Release: The LMA publishes an exposure draft multicurrency rate swith facility agreement*, (11 September 2020), available at: https://www.lma.eu.com/news-publications/press-releases?id=181.

successor rates, particularly around the credit spread adjustment, means that participants in the syndicated loan market may be hesitant to document using compounded SONIA/SOFR in arrears. Similarly, the fallback introduced by the ISDA protocol may not be economically appropriate for non-linear interest rate derivatives such as in-arrears swaps. Should market consensus coalesce definitively around the historic mean/median approach as a means of determining the credit spread adjustment, the mechanics of administering the rates remain the subject of much discussion. Another question needing consideration in this context is who would pay for the cost of changing the rate. The Benchmarks Supplement includes the notion of an Adjustment Payment but this has to be agreed between the parties.[47]Although competition law issues are beyond the scope of this report, it can be noted that an agreement on pricing will *prima facie* contravene Article 101 of the Treaty on the Functioning of the European Union and section 2 of the Competition Act 1999, (unless the arrangement represents a contribution to technological or economic progress, or improves the production or distribution of goods, to the ultimate benefit of consumers). Presumably, then, an arrangement to introduce a successor reference rate by means of the fallback mechanisms of reference banks and/or calculation agent—if it were possible at all—would require stringent oversight, or even active management by national authorities, to counteract the inherent conflicts of interest to which collective price-setting arrangements ordinarily give rise.

5. CONCLUSION

5.1. In this paper, the FMLC has set out the residual uncertainties arising with respect to legacy contracts in the context of the transition away from LIBOR to a successor rate. It has explored possible solutions which might be adopted by HM Government, regulatory authorities or market participants to mitigate the legal uncertainty and set out the strengths and weaknesses of each. As is evident, each possible mitigant gives rise to further unintended consequences or difficulties. In this context, the possibility of amending the feeds on the Bloomberg and Reuters LIBOR01 pages so that a successor rate is displayed instead, under the "LIBOR" rubric appears to offer the best prospect

[47] In the event that the parties don't reach an agreement and neither party exercises its close-out right, the right to determine the rate reverts to the Calculation Agent in respect of which other complexities arise. For example, parties looking to dispute determinations made by the Calculation Agent are subject to the very short cut-off times of two business days. Further, the Benchmarks Supplement requires "reasonable" grounds for a dispute to the Calculation Agent's determination, and there's little guidance on what would constitute reasonable, and provides no comfort that the replacement rate under any ISDA agreement would match the rate being used in a party's other agreements, meaning a mismatch remains a possibility.

for avoiding disruption in the wholesale financial markets. The touchstone for market standard definitions referring to LIBOR is often the publication of the rate on the Reuters or Bloomberg Screen LIBOR01 Page. Continuing to publish values on these screens under the LIBOR rubric should provide comfort that adjustments to the rate-setting process for LIBOR will not give rise to contractual uncertainty for so long as the rate which is set by that process is published on the LIBOR01 Screen. Were this to be adopted, the publication of a strong legal opinion could provide the market with reassurance that the adjustments are not such as have taken the rate outside the market standard contractual definitions. This solution bears some similarity to the proposed plan for a Transition LIBOR, which will be detailed in the forthcoming Financial Services Bill—although the latter involves the additional complexity of addressing requirements in respect of methodological change to the LIBOR administrator. The plan will face the challenges discussed above and will not fully resolve uncertainty over the transition. Nevertheless, the FMLC takes the view that, with careful international consultation and cooperation among regulators in different jurisdictions and careful inventory assessment and planning by market participants, it offers the best prospect for a smooth transition.

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