TRANSITION MOMENTUM INCREASES

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

- **KEY PRIORITIES FOR STERLING MARKETS**
- **MORE SUPPORT FOR STERLING TRANSITION**
- **FOCUS ON NON-LINEAR DERIVATIVES**
- **NEW FORMS FROM THE LMA**
- **LCH CONFIRMS CONVERSION DATES**
- **US DOLLAR ACTIVITES ACCELERATE**
- **A CLOSER LOOK: TERM RISK FREE RATES**

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

KEY PRIORITIES FOR STERLING

Following the Financial Conduct Authority's (FCA) early March 2021 formal announcement of the cessation dates for LIBOR, the sterling markets reached another key milestone on 1 April 2021: to stop using sterling LIBOR in new lending and linear derivatives (e.g. swaps) that mature after the end of 2021. News and developments over the past month, however, only help to highlight that these recent mile-stones represent only the beginning, rather than the end, of what needs to be done before the end of the year.

This sentiment was reflected in a joint letter from the UK Prudential Regulation Authority (PRA) and the FCA to CEOs of supervised firms on 26 March 2021, which set out the supervisory expectations of the transition from LIBOR to risk-free rates (RFRs). The letter reinforces that regulators expect all firms to meet the Bank of England Working Group on Sterling Risk-Free Reference Rates (BoE WG) upcoming milestones and the targets from other working groups as appropriate.

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

MORE SUPPORT FOR STERLING TRANSITION

To assist in meeting upcoming milestones, the BoE WG has issued a number of new supporting materials. It published a statement on 23 April 2021, which sets out a range of considerations intended to help market participants across GBP bond, loan and derivative markets, assess and prioritise the active transition of legacy GBP LIBOR contracts to SONIA. On the same day, the BoE WG provided a paper aimed at market participants who may wish to rely on ISDA's fallbacks providing a number of infrastructure and operational considerations to inform their planning and preparation for the operationalisation of fallbacks in non-cleared linear GBP LIBOR deriva-tives.

These materials, followed the release of a paper on 19 April 2021, detailing some key considerations for new issuance in structured products referencing compounded in arrears SONIA, as well as providing some high-level views to support the transition of legacy GBP LIBOR structured products. The paper is intended to assist issuers, manufacturers, distributors and investors in their transition plans.

NON-LINEAR DERIVATIVES IN FOCUS

One major BoE WG milestone on the horizon is the requirement for supervised entities to cease initiating any new sterling LIBOR-linked non-linear derivatives that expire after 2021 by the end of Q2-2021 – except in those situations where it is required for risk management of existing positions. In a supporting move to encourage sufficient market liquidity to meet this milestone, the Bank of England (BoE) and FCA issued a joint statement of support on 29 March 2021, directing market makers in the sterling non-linear derivatives market to adopt new quoting conventions for inter-dealer trading based on SONIA from 11 May 2021.

NEW FORMS FROM THE LMA

It is well understood that more than just regulatory initiatives are required to achieve transition – the support of market bodies and industry groups, like the Loan Market Association (LMA), remain key pillars of success. The LMA, in order to help accelerate further transition activity in the syndicated loan space, on 29 March published a set of recommend forms of templates for loan agreements which reference RFRs, which amongst others items, includes the most recent updates to the BoE WG's supporting material on detailed loan conventions. The suite of material includes updates to the notes outlining LIBOR transition considerations for the LMA's wider suite of documentation.

LCH CONVERSION DATES

Meanwhile, following an announcement in February 2021 that it would run a LIBOR conversion event, the London Clearing House (LCH) published supplementary information including the proposed dates of Friday 3 December 2021 for CHF, EUR & JPY LIBOR and Friday 17 December 2021 for GBP LIBOR.

US DOLLAR ACTIVITIES ACCELERATE

The US Alternative Reference Rates Committee (ARRC) has set a key milestone to end new US dollar LIBOR activity at the end of the year and has recently made a series of announcements to support transition efforts in US dollar lending markets. On 17 March 2021, the ARRC announced that it has selected Refinitiv to publish the ARRC recommended spread adjustments and spread adjustment rates. This will make these rates readily accessible on a daily basis to the public, free of charge. It also published a white paper on 29 March 2021, promoting use of the Secured Overnight Financing Rate (SOFR) in asset-backed securities. In addition, on 7 April 2021, the ARRC provided an endorsement of the signing of new LIBOR legislation into New York State law which addresses the issues of legacy contracts referencing US dollar LIBOR that mature after mid-2023 and do not have effective fallbacks.

In similar fashion to regulators in the UK, the Federal Reserve Board (FRB) on 9 March 2021 published guidance for examiners in assessing supervised firms' LIBOR transition progress. The guidance directs examiners to consider issuing supervisory finding s and other supervisory actions for firms that are not prepared to stop using LIBOR by 31 December 2021.

A more in-depth look at the progress of US dollar LIBOR transition, up to 31 March 2021 is provided by the ARRC's latest Progress Report, which ends with an outline of some of the key steps ahead.

A CLOSER LOOK: TERM RISK FREE RATES

Term RFRs have received some attention in recent weeks. In the case of the US dollar, the ARRC has issued a statement that contrary to its previous objective it will not be in a position to recommend a forward-looking SOFR, commonly referred to as Term SOFR, by the middle of 2021. The basis for the decision was lack of liquidity in the SOFR derivatives market to formulate a sound term rate and the need to further evaluate the anticipated limited scope of use for Term SOFR.

Nevertheless, the ARRC did provide on 20 April 2021, the key principles that it believes are necessary to recommend a forward looking SOFR term rate. On the following day the Chicago Mercantile Exchange Group (CME), announced that it is publishing Term SOFR reference rates for 1-month, 3-month and 6-month tenors for the time being on an unendorsed basis.

In terms of sterling, FTSE Russell has decided to discontinue their production of Term Sterling Overnight Index Average (SONIA); this now leaves ICE Benchmark Administration (IBA) and Refintiv as the sole providers in this space.

Term RFRs, such as Term SONIA are being developed because the underlying RFR rates are just overnight rates – reflecting the interest rate for a particular day only. Term RFRs, on the other hand, reflect the expected average rate of a designated risk-free rate over a given future period in similar fashion to e.g. 3 month LIBOR. However, unlike LIBOR, the RFR term rates cannot be based on actual transactions as SONIA, SOFR and other RFRs are overnight rates. Nor by design, do they reflect term bank credit risk like LIBOR. For more information on the topic from the BoE WG please see here.

So, although term RFRs might at face value appear like an apparently perfect like-for-like substitute for LIBOR in terms of forward rate calculation, there are a number of challenges to them being used as a robust alternative both in US dollar and sterling markets.

Hence the FCA has stated that 'the use of these forward-looking rates is meant to be limited' and the BoE WG has recommended that in the majority of cases SONIA compounded in arrears is the replacement rate for LIBOR. Term SONIA is only recommended for very limited use in trade, working capital, and Islamic financing situations.

More recently the FICC Markets Standards Board (FMSB) has published a proposed standard on use cases for Term SONIA rates in sterling markets, which also highlights some of the challenges related to term rates, inviting comments on the proposals by 28 May 2021. This was welcomed by the BoE, FCA and BoE WG.

Just like with Term SONIA, the ARRC in the US envisages a similar limited use case for Term SOFR. Equally, the ARRC encourages market participants not wait for a term rate and to make use of the simple or compounded SOFR conventions currently available. In turn, the ARRC has recommended a number of actions aimed at building liquidity in SOFR derivatives that would help support the robustness of any recommended term rate.

Still, the delay of an official sector, fully endorsed solution for Term SOFR will have implications for trade & working capital products in terms of when and onto what these will transition before the end of the year, as a large percentage of the market currently relies on US dollar LIBOR.

Cris Kinrade
IBOR Transition Programme
Lloyds Bank Commercial Banking

DISCLAIMER

This communication, its contents and any related communication ("this communication") was prepared by Lloyds Bank (for the purposes of this notice "Lloyds Bank" means Lloyds Banking Group plc, its subsidiaries and any of its group companies). This communication (1) shall not be relied on in connection with or be construed as a contract or commitment and shall not form the basis of or be relied on in connection with any transaction, contract or communication whatsoever; (2) is for information purposes only and is not intended to form and should not form the basis of any investment decision; (3) is not and may not be treated as investment research, a recommendation, an opinion or advice of any kind (including without limitation legal, compliance, financial, accounting and/or taxation); (4) is subject to the copyright of Lloyds Bank; (5) is based on current public information and is in summary form and, therefore, may not be complete; and (6) may only be accessed by recipients lawfully entitled to do so. By receiving this communication, you agree to its contents and requirements.

Lloyds Bank has exercised reasonable care in its preparation, but no representation or warranty is made by Lloyds Bank, and its or their directors, officers, employees, associates and agents (together the "Lloyds Bank Persons") as to the accuracy, suitability, fairness, adequacy, correctness or completeness of the information or opinions herein. In particular, no Lloyds Bank Person is, and none should be considered to be, giving an accounting opinion or advice and you should conduct your own independent enquiries and obtain independent professional advice. Any transaction which you may enter into with Lloyds Bank will be on the basis that you have made your own independent evaluations, without reliance on Lloyds Bank, and based on your own knowledge and experience and any professional advice which you may have sought in relation to all aspects of the transaction including without limitation legal, compliance, financial, accounting and/or taxation advice. You will not use this communication to the detriment of any Lloyds Bank Persons.

No Lloyds Bank Person is acting as a fiduciary in relation to you. Lloyds Bank Persons and their clients (i) may engage in transactions in a manner inconsistent with any statement or opinion in this communication; (ii) may trade as principal in securities and/or assets and/or derivatives and/or any other financial products. Information may be available to Lloyds Bank Persons which is not reflected in this communication. Lloyds Bank may have a perceived or actual conflict of interest in relation to the matters referred to in the communication. Lloyds Bank has internal systems, controls and procedures to ensure that conflicts of interest are identified and appropriately managed.

This communication is current at the date of publication and the content is subject to change without notice. Information and opinions herein have not been independently verified or reviewed, and Lloyds Bank is not obliged to update or correct this communication. This communication may contain forward-looking statements or refer to future events or results not within the control of Lloyds Bank Persons. No representation or warranty is made as to the correctness of any forward-looking statement or whether any such event or result will occur. To the fullest extent permitted by applicable law and regulation, no Lloyds Bank Person accepts any responsibility for and shall have no liability for any loss (including without limitation direct, indirect, consequential and loss of profit), damages, or for any liability to a third party however arising in relation to this communication (including without limitation in relation to any projection, analysis, assumption and opinion in this communication). In no circumstances will any Lloyds Bank Persons be responsible for any costs, taxes or expenses incurred by any recipient in connection with any investigation of this communication or any subsequent transaction.

No Lloyds Bank Person provides legal, compliance, financial, tax, professional, regulatory or accounting advice. Accordingly, any statements contained in this communication on tax matters were neither written nor intended to be used, and cannot be used by any taxpayer, for the purpose of avoiding tax penalties that may be imposed on such taxpayer.

Lloyds Bank Persons may participate in benchmarks in any one or more of the following capacities: as administrator, submitter or user. Benchmarks may be referenced by Lloyds Bank Persons for internal purposes or products, services or transactions provided to or engaged in with you. More information is found in the Benchmark Transparency Statement on our website.

Lloyds Bank is a trading name of Lloyds Bank plc, Bank of Scotland plc and Lloyds Bank Corporate Markets plc. Lloyds Bank plc. Registered Office: 25 Gresham Street, London EC2V 7HN. Registered in England and Wales no. 2065. Bank of Scotland plc. Registered Office: The Mound, Edinburgh EH1 1YZ. Registered in Scotland no. SC327000. Lloyds Bank Corporate Markets plc. Registered office 25 Gresham Street, London EC2V 7HN. Registered in England and Wales no. 10399850. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority under registration numbers 119278, 169628 and 763256 respectively.

Please seek independent financial and legal advice if you have any questions about any of the issues raised in this communication