LLOYDS BANK

IBOR TRANSITION NEWSLETTER

Edition 22: December 2021

COMMERCIAL BANKING

LAST ORDERS

Welcome to our Newsletter. This is our twenty-second, and final, edition providing an update on the transition away from the London Interbank Offered Rate (LIBOR) and other Interbank Offered Rates (IBORs). As the cessation of EONIA and most of LIBOR's 35 tenors draws ever closer, there are a number of important points to cover since our previous edition, including:

- **FCA GUIDELINES FOR SYNTHETIC LIBOR AND US DOLLAR LIBOR**
- **UK CRITICAL BENCHMARKS BILL PROGRESSES**
- **EU STATUTORY REPLACEMENT RATES**
- **US REGULATORS FOCUS INTENSIFIES**
- **TOWARDS GREATER LIQUIDITY IN SOFR**
- **RECENT DEVELOPMENTS IN JAPAN**
- **A CLOSER LOOK: FCA ANNOUNCEMENTS OF 16 NOVEMBER 2021**

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

FCA GUIDELINES FOR SYNTHETIC LIBOR AND US DOLLAR LIBOR

The UK Financial Conduct Authority (FCA) has been busy exercising its new powers under the Benchmark Regulation in recent months. On 29 September it confirmed its decisions to compel continued publication of 1, 3 and 6 month sterling and Japanese yen LIBOR settings on a 'synthetic' basis for a limited time after the end of 2021 for use in legacy contacts only; they can't be used for new contracts.

The rates will be determined using a synthetic methodology and will no longer be considered 'representative' as defined in the UK Benchmarks Regulation (UK BMR).

Following on from its consultation proposals published in June, the FCA also confirmed the methodology it will require LIBOR's administrator to use for calculating the synthetic rates. The first non-representative publication of the relevant tenors on a synthetic basis will be on 4 January 2022. The FCA has stressed that **"Users of LIBOR should continue to focus on active transition rather than relying on synthetic LIBOR."**

At the same time the FCA published it's promised consultation on the use cases that it will consider appropriate for use of synthetic LIBOR, as well as proposals for ceasing the use of USD LIBOR in new contracts from the end of the year. The synthetic LIBOR proposals were supported by respondents to the consultation in avoiding potential disruption to interest payments on loans, mortgages, bonds, and other contracts that haven't switched by 31 December 2021.

On 16 November the FCA confirmed that following the outcome of this consultation, all legacy contracts (other than cleared derivatives) will be permitted to use the synthetic versions of LIBOR, subject to the availability of the relevant tenors and currencies, and that new use of USD LIBOR by supervised entities after 31 December 2021 will be prohibited (subject to certain exceptions).

UK CRITICAL BENCHMARKS BILL PROGRESSES

Following its introduction to the parliamentary process via the House of Lords on 8 September 2021 the Critical Benchmarks (Reference and Administrators Liability) Bill, which is intended to provide a basis in UK law for contracts to substitute LIBOR for synthetic LIBOR, has continued its passage through Parliament by completing three readings in the Lords before passing to the Commons and receiving its first reading on 3 November. It was then debated in the Commons on 18 November 2021 and subsequently completed all stages (second reading, Committee Stage and third reading). With no amendments introduced the Bill now only needs to receive Royal Assent before passing onto the statute books; this is expected to happen before the end of the year.

EU STATUTORY REPLACEMENT RATES

As reported previously a slightly different approach to a legislative solution for LIBOR cessation has been taken in the European Union, and on 14 October the European Commission formally adopted an implementing regulation designating the Euro short-term rate (€STR) with a fixed spread adjustment of 8.5 basis points as the statutory replacement rate for EONIA in any contract and financial instrument. This regulation, which applies from 3 January 2022, follows the adoption of an implementing regulation for the statutory replacement rates for CHF LIBOR on 14 October which will come into effect on 1 January 2022.

At their most recent meeting the Working Group on Euro Risk Free Rates also discussed whether to designate statutory alternative rates to GBP and JPY LIBOR under EU law. So far they haven't been able to reach consensus due to the operational difficulties of implementing any designated alternative rate before the end of the year, and the added risk of contract frustration and litigation in the absence of a Safe Harbour mechanism under EU law for the use of synthetic LIBOR. The Chair of the EU Working Group subsequently wrote to the European Commission asking for clarification as soon as possible on the approach they intend to take.

Meanwhile with the end of Euro Overnight Index Average (EONIA) coming into sight the London Clearing House confirmed the conversion of all of its swaps referencing the benchmark to €STR was taking place on 15 October 2021.

US REGULATORS' FOCUS INTENSIFIES

In the US, regulators are keen to make sure that the market doesn't take its foot off the gas due to the continuing publication of 5 USD LIBOR tenors after the end of the year. On 20 October they issued a joint statement emphasising their expectation that supervised institutions with LIBOR exposure continue to progress towards an orderly transition. The statement also includes clarification on the meaning of new LIBOR contracts, considerations for assessing alternative reference rates, and expectations for fallback language. This approach was supported by recommendations from the Alternative Reference Rates Committee (ARRC) that all market participants take proactive action now to reduce their use of USD LIBOR to promote a smooth end to new LIBOR contracts by year end. Both statements reference the previous joint statement from regulators issued last November encouraging banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable, but by 31 December 2021 at the latest.

The joint statement follows warnings in a speech earlier in the month from the Vice Chair of Supervision for the Federal Reserve, Randal J Quarles, that the Federal Reserve will intensify its focus on financial institutions' transition planning as LIBOR cessation nears. He observed that the use of USD LIBOR after 2021 would "pose safety and soundness risks" and highlighted the supervisory efforts by banking regulators, in particular the letter in November 2020, encouraging banks "to transition away from USD LIBOR as soon as practicable".

In terms of providing further support, as opposed to "encouragement", for transition during October, the Office of the Comptroller of the Currency (OCC) made a tool available for banks to evaluate their preparedness for the LIBOR cessation; the Department of Housing and Urban Development (HUD) announced an Advanced Notice of Proposed Rulemaking (ANPR) for adjustable rate mortgages transitioning from LIBOR to alternate indices; and the ARRC held its 6th SOFR Symposium and released a summary of its recommendations to date regarding spread-adjusted fallbacks for USD LIBOR.

TOWARDS GREATER LIQUIDITY IN SOFR

A corollary of USD LIBOR transition is robust and liquid markets in SOFR. To this end earlier this year the Interest Rate Benchmark Reform Subcommittee of the CFTC Market Risk Advisory Committee (MRAC) formally adopted SOFR First - a phased initiative for switching trading conventions from LIBOR to SOFR for linear interest rate swaps, cross currency swaps, non-linear derivatives and exchange traded derivatives. On 15 October MRAC recommended that the third phase for non-linear derivatives begin on 8 November. The recommendation applies to swaptions, caps and floors, but excludes "exotic" options such as Bermudan options and constant maturity swaps, which may continue trading in the interdealer market after 8 November 2021. The date of the change for exchange traded derivatives is still to be announced.

Further indication of a stronger SOFR market and support for MRAC initiative was provided by the launch on 8 November 2021 of the SOFR ICE Swap Rate® for use as a benchmark in financial contracts and financial instruments by licensees. This follows the publication of beta settings on 1 October 2021.

RECENT DEVELOPMENTS IN JAPAN

In a series of initiatives complementary to those in the UK at the end of September, the Cross Industry Committee on Japanese yen interest rates published a consultation on the treatment of tough legacy contracts in Japan including the use of synthetic JPY LIBOR. The outcome is due to be published before the end of November. The Committee also published its guidelines on ceasing the issue of any new interest rate swaps referencing JPY LIBOR, other than for the risk management of existing positions, from the end of September 2021.

Alongside the Financial Services Agency (JFSA) the Committee has conducted a survey of financial institutions regarding their use of LIBOR to establish exposure in preparation for permanent cessation and to encourage institutions to push ahead with their preparations for a smooth transition; the results were published on 1 November 2021.

A CLOSER LOOK: FCA ANNOUNCEMENT OF 16 NOVEMBER 2021

As reported above the FCA made a key announcement during November on the use of Synthetic GBP and JPY LIBOR tenors in legacy business and stopping the use of USD LIBOR in new business after 31 December 2021. The announcement answers a number of important questions and was accompanied by a series of publications - more detail is provided below.

A: Notices on the FCA powers over the use of LIBOR

(i) Article 23c – draft notice of permitted legacy use by supervised entities

The FCA confirm their proposals to use their power to permit legacy use of the continuing 1, 3 and 6 month sterling and Japanese yen LIBOR in all contracts except cleared derivatives. No limitations or conditionality will be applied to these permissions, at least for the duration of 2022. The draft notice also sets out a summary of reasons as to why legacy use of LIBOR by supervised entities beyond the end of this year is being permitted.

In their core announcement the FCA nevertheless continue to discourage the use of such permanently unrepresentative benchmarks. Edwin Schooling Latter, Director of Markets and Wholesale Policy comments: '… work should not stop here. While synthetic LIBOR reduces risk in the transition and provides a bridge to Risk-Free Rates like SONIA, it will not last indefinitely and contracts need to be moved away from LIBOR wherever possible.'

(ii) Article 21a benchmarks regulation – notice of prohibition on new use of a critical benchmark

The FCA confirmed that after 31 December 2021 they will prohibit new use of the continuing overnight, 1, 3, 6 and 12 month USD LIBOR settings. This is in line with both US guidance and existing FCA and PRA supervisory expectations.

There are exceptions to this prohibition, as follows:

(1) Market making in support of client activity related to US dollar LIBOR transactions executed before 1 January 2022 (Annex 1 of the notice provides further clarity).

(2) Transactions that reduce or hedge the supervised entity's or any client of the supervised entity's US dollar LIBOR exposure on contracts entered into before 1 January 2022.

(3) Novations of US dollar LIBOR transactions executed before 1 January 2022.

(4) Transactions executed for the purposes of participation in a central counterparty auction procedure in the case of a member default, including transactions to hedge the resulting US dollar LIBOR exposure.

(5) Interpolation or other use provided for in contractual fallback arrangements in connection with the US dollar LIBOR Versions that will cease at 31 December 2021 (the 1 week and 2 month USD LIBOR Versions).

B: Feedback statement to consultation on proposed decision under Article 23D (CP21/19)

On 16 November 2021, the FCA also published a feedback statement to the original [consultation] in which they proposed to require the administrator of LIBOR, ICE Benchmark Administration (IBA), to publish 1 month, 3 month and 6 month sterling and Japanese yen LIBOR settings under a changed, synthetic methodology for a limited period beyond end-2021 for use in legacy contracts. This **synthetic methodology** would be based on the relevant forward looking term risk-free rates (RFRs) and the ISDA spread adjustments for the relevant LIBOR settings.

The statement demonstrates that this decision is supported by a large majority of market respondents. It also notes that, following the consultation responses, the FCA decided to adjust their proposed methodology for each of the 3 Japanese yen LIBOR settings to account for day count differences between yen LIBOR and Tokyo Term Risk Free Rate (TORF). Therefore, in using TORF as a component for the calculation of each of the 3 Japanese yen settings, IBA will be required to multiply the value of TORF for the relevant setting published for an applicable London business day by 360/365.

Finally the feedback statement also makes clear the FCA's view that 'We do not expect the changes in the underlying methodology to affect how LIBOR should continue to be displayed on the relevant screen pages'.

C: Updates to FCA borrower facing webpage

As part of the finalisation of their tough legacy policy, the FCA updated their webpage on Mortgage interest rates and LIBOR: information for borrowers. The Q&A now includes high-level consideration of the approaches to transition deemed fair by the FCA, synthetic LIBOR methodology and the potential interest payment increase at year-end, as well as the continued need for borrowers to respond to lenders when contacted about transition. The website includes an explanation of the credit adjustment spread logic and potential impact on payments.

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