LLOYDS BANK

IBOR TRANSITION NEWSLETTER

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COMMERCIAL BANKING

PREPARING FOR THE END

Welcome to our Newsletter. This is our thirteenth edition and it provides an update on the transition away from the London Interbank Offered Rate (LIBOR) and other Interbank Offered Rates (IBORs). The key topics for this month are:

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

TOP PRIORITIES FOR 2021

Despite the significant progress made on LIBOR transition over 2020, the Financial Stability Board's (FSB) annual progress report high-lighted that work "needs to accelerate in early 2021" as the production of LIBOR can no longer be guaranteed after 2021. In addition, the FSB outlined two top priorities for 2021: 1) stop new LIBOR referencing contracts globally as soon as possible; and 2) promote active transition of legacy contracts referencing LIBOR.

These dovetail with the three priority actions outlined by Andrew Hauser, Executive Director for Markets at the Bank of England (BoE) in a speech on 9 December: first, move all your new business off LIBOR as soon as possible this year – and by the end of March for sterling; second, sign the ISDA protocol or make firm alternative plans; and third, work hard to convert any remaining legacy contracts away from LIBOR.

With the end-Q1 deadline to cease issuance of new sterling LIBOR-based loan products in mind, both industry and regulators have increased their activity in the sterling loan space over the past few months.

This acceleration comes as a number of key consultations are due to close in the coming weeks, not least the ICE Benchmark Adminis-trator's (IBA) proposal to cease the publication of LIBOR settings. Concluding the IBA consultation will open the door for an "index cessation event", which will, amongst other things, set the 5 year historical median credit adjustment spread (CAS) under the International Swaps and Derviative Association's (ISDA) 2020 IBOR Fallbacks Supplement (Supplement) and 2020 IBOR Fallbacks Protocol (Proto-col). An "index cessation event" due to a "Pre-cessation" announcement from the Financial Conduct Authority (FCA) is expected soon after the consulation closes on 25 January 2021. Other important consultations are also due to conclude soon and are discussed in the *A Closer Look* section of this month's newsletter.

LIMITED USD LIBOR AFTER 2021

In a necessary first step toward the eventual cessation of LIBOR, the IBA published, on 4 December, a formal consultation on its proposals to cease the publication of LIBOR settings. Notably, the consultation confirmed the IBA's earlier announcement from November 2020 that all USD LIBOR settings, except for 1 week and 2 month, would potentially not be ceasing until after 30 June 2023. Whereas, GBP, EUR, CHF and JPY LIBOR settings are still anticipated to cease on or around 31 December 2021, subject to any rights of the FCA to compel the IBA to continue beyond those dates.

The US regulatory bodies provided supervisory guidance on **limiting new use of USD LIBOR after end-2021**. Banks are being encouraged to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable, and are expected not to use LIBOR after 31 December 2021. **In other words, USD LIBOR's life is only being extended for existing contracts executed before the end of 2021.** The Alternative Reference Rates Committee (ARRC) in the US applauded the announcements;other statements of support were forthcoming from a number of market representative bodies such as the Structured Finance Association, and the FCA issued a statement welcoming the IBA's intention to consult on USD LIBOR.

The IBA consultation is open for feedback until 25 January 2021. Once the feedback period is closed, IBA will share the results of the consultation with the FCA and publish a feedback statement summarising responses shortly thereafter.

IBA CONSULTATION IN CONTEXT

The IBA consultation has brought into focus LIBOR's end date, and the associated impact upon contractual obligations; but it is important to distinguish between the consultation on cessation and an actual "index cessation event".

ISDA did exactly that, when it published a statement on 30 November 2020, where it clarified that neither the IBA announcement on USD LIBOR cessation nor the statements welcoming that announcement from the FCA and the Federal Reserve Board (FRB), constituted an "index cessation event" under the the Supplement or the Protocol. Therefore, these statements do not trigger the fallbacks under the Supplement or Protocol (i.e. to the adjusted risk-free rate plus spread) nor do they have any effect on the calculation of the credit adjustment spread. Also, these statements do not trigger fallbacks under the 2018 ISDA Benchmarks Supplement or its protocol, which also provides a framework for the fallbacks. Shortly after the consultation closes on 25 Janaury 2022, however, most observers expect the FCA to make an announcement that will trigger an index cessation event by way of a "pre-cessation" announcement.

HELPFUL RESOURCES

The IBA consultation, and general increased activity over recent months, has spurred the publication of additional reference materials and resources for market participants.

On 4 December 2020 ISDA held a webinar featuring remarks from their CEO Scott O'Malia, David Bowman of the FRB, Edwin Schooling Latter of the FCA, Deepak Sitlani of Linklaters and Tom Wipf of Morgan Stanley at which they looked to answer some of the questions arising from IBA's announcement of their intention to consult on the cessation of various LIBOR settings. This was followed on 7 December 2020 by the publication of a video explaining some of the common misunderstandings that may arise in relation to fallbacks.

At the same time, the ARRC issued a guide on the end game for USD LIBOR. The guide places recent announcements made by US and UK regulators and LIBOR's administrator into context with the ARRC's ongoing initiatives. In addition to walking through the announcements, the guide covers what is on the horizon for USD LIBOR's endgame including the ARRC's work on the setting of a spread adjustment, the legislative proposals with the New York State and it's Recommended Best Practices.

FOCUS ON GBP LOANS

Meanwhile, with GBP LIBOR loan transition deadlines and expected cessation dates looming much sooner than those for USD, industry and regulators have been active in the GBP loan space. The BoE initiated Working Group on Sterling Risk-Free Reference Rates (BoE WG) was particularly busy in December 2020. Ahead of the end-Q1 deadline to cease issuance of new sterling LIBOR-based loan products, the BoE WG released a guide to help lenders, borrowers and infrastructure providers in determining intermediate steps within their firms to meet that timeline.

Matters of a more technical nature were also addressed. For example, the BoE WG Loan Enabler Taskforce published a paper on credit adjustment spread (CAS) methods for use in the active transition of GBP LIBOR referencing loans. Previously in September 2020, the BoE WG had recommended the use of a five-year historical median methodology for CAS for use in fallbacks related to cessation or pre-cessation events.

On a related topic, the Chair of the BoE WG wrote to Bloomberg Index Services Limited (BISL) to facilitate a better understanding of the access of cash market participants, particularly for end users, to its published credit adjustment spreads based on the ISDA historical five year median approach. The letter requests BISL's assistance to enhance its current IBOR Fallbacks Factsheet to provide further clarity on matters relevant to cash market participants.

Furthermore, operational considerations received attention. In an open letter to loan system vendors and treasury management system providers, the BoE WG asked them to ensure they provide support to clients and the market in their transition away from LIBOR. Vendors were asked to ensure that their software is able to accommodate the BoE WG's loan market convention recommendations ahead of end-Q1 2021.

LLOYDS BANK AND THE LMA

The BoE WG has not been the only active group. Earlier in November 2020, the Lending Markets Association (LMA) published a series of documents to further assist market participants when incorporating active transition mechanisms into their loan documents. These included a revised exposure draft rate switch facility agreement (lookback without observational shift); a new exposure draft rate switch facility (lookback with observational shift); revised commentary relating to rate switch facility agreements; and risk-free rates (RFR) terms for use with the Supplement to revised replacement of screen rate language.

Lloyds Bank continues to support the lending market in its transition efforts, and an interview with our senior manager of Lending Operations and Agency, covering agents' approach to transition, has also been included by the LMA in their [recently released] reference/support material.

OTHER NEWS

In line with the timelines included in the BoE WG roadmap, on 5 January 2021, Refinitiv announced that on 11 January 2021 it will launch the Refinitiv Term SONIA benchmark. The IBA launched its ICE Term SONIA Reference Rates on 11 January 2021 for use as a benchmark in financial instruments by licensees. Term SONIA rates will be used in limited use cases, such as with trade finance, but are not envisaged to be broadly available for use.

The European Commission (EC) issued a statement on the 30 November 2020 welcoming the agreement reached by the European Parliament and the Council on amendments to the Benchmark Regulation. This Agreement empowers the Commission to designate a replacement benchmark, that covers all references to a widely used reference rate that is phased out such as LIBOR, as and when necessary to avoid disruption in the EU financial markets.

On 4 December 2020 the Swiss Financial Markets Authority (FINMA) published guidance which recommends supervised institutions such as banks, securities firms and insurance companies, take action in order to be fully prepared for publication of the expected cessation of most of the widely-used LIBOR settings by end of 2021.

A CLOSER LOOK: OPEN CONSULTATIONS

In addition to the IBA consultation on the direct cessation of LIBOR, the market and official sector are publically consulting on a number of other aspects of LIBOR transition. The majority of these 'other consultations' are due to close during January 2021, meaning that by the end of Q1 2021, their outcomes and the way forward should be clarified for all market participants. Listed below are some consultations that may prove most impactful to clients by category:

- **Tough Legacy & Cessation**: First out of the blocks on 18 November 2020 was the FCA with two consultations on the proposed approach to the exercise of its new powers under the Financial Services Bill for (i) designating a benchmark to be unrepresentative and (ii) for requiring changes to be made to a critical benchmark including its methodology. Responses on both of these consultations are expected by 18 January 2021.

- **EURIBOR Fallbacks:** The following week, on 23 November 2020, the working group on euro risk free rates (EU RFR WG) released two consultations on EURIBOR fallbacks. Stakeholders are asked to provide their views on (i) fallback rates based on the euro short-term rate (€STR) and spread adjustment methodologies and (ii) the potential events that could trigger such fallback measures. Feedback is requested by 15 January 2021 on both consultations.

- **Cleared Derivative Transition:** On 14 December 2020 (and of specific relevance to those institutions with cleared interest rate swap transactions referencing LIBOR that are maturing after the end of 2021) the London Clearing House (LCH) published a proposal to its members where, rather than relying upon the ISDA fallbacks at cessation, all LIBOR trades remaining on a confirmed index at (or shortly before) the cessation effective date will be converted to market-standard Overnight Indexed Swap (OIS) contracts. The LIBOR floating rate will be replaced by the relevant compounded RFR; with LCH paying cash compensation for any valuation difference between the original LIBOR trade and the new RFR contract. The deadline for response to LCH is 29 January 2021.

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