FSR OUTLOOK 2021: LIBOR 2021: THE FINAL COUNTDOWN

09 December 2020 | Global
Guides

It won't come as news to anyone in the financial services industry that LIBOR benchmarks are expected to cease after end-2021 – this has been on the cards since 2017 when Andrew Bailey, then Chief Executive of the UK FCA, announced that the contributor panel banks had agreed to sustain LIBOR (only) until that time and that "*work must … begin in earnest on planning transition to alternative reference rates that are based firmly on transactions*".

In a nutshell:
- **With LIBOR benchmarks due to cease after end 2021, firms need formalised plans to amend legacy contracts and robust systems to enable transition to alternative rates**
- **Firms should expect increased scrutiny during 2021 and should have records to evidence the steps taken**
- **Timely, clear and fair communications with customers will be critical**
- **Legislative proposals for tough legacy contracts are beginning to emerge but the territorial jigsaw remains a genuine puzzle**

It's fair to say that that work has ramped up in recent months, not least to meet the 2021 milestones set by various relevant bodies. The Financial Stability Board (**FSB**) for instance has said that, by mid-2021, "firms should have established formalised plans to amend legacy contracts where this can be done and have implemented the necessary system and process changes to enable transition to robust alternative rates".

Here we consider 6 key areas to have in mind as we enter the LIBOR 'endgame'.

1. READINESS

The first is readiness.

In relation to existing contracts - are you confident you have identified the total population of affected contracts, including those with indirect, as well as direct, references to LIBOR? In that regard, have you undertaken what the Financial Conduct Authority (**FCA**) described in its ‘Feedback to its Dear CEO letter on LIBOR transition’ as a “thorough stocktake”? The FSB’s expectation is that this has already been done.

For new contracts, industry working groups have set 2021 deadlines by which the cash market should stop issuing LIBOR linked loans expiring post-2021 – for example, in Singapore, the Steering Committee for SOR Transition to SORA (**SC-STS**) has plumped for the end of April 2021, and the Alternative Reference Rates Committee (**ARRC**) in the US for the end of Q2 2021, with the Working Group on Sterling Risk-Free Reference Rates (**RFRWG**) in the UK opting for the earlier date of end of Q1 2021. Are systems, processes and controls ready - not just those directly relevant to the issuing of loans, but also related system infrastructure?

Avoiding the problem won't make it smaller or change the need to transition. The answer is for us collectively

to confront the challenge and make the necessary progress over the next 18 months.”

- Andrew Bailey, Bank of England

Firms should expect increased regulatory supervisory scrutiny as we move into and through 2021.

2. RIGHT TIME

Regulators globally have emphasised the need to communicate with customers in a timely way.

In the UK, the FCA has said “*Information should be presented in good time to allow customers to make informed decisions about relevant products and the risks to which the customer may be exposed. We encourage firms to keep their customers appropriately informed about the impact of LIBOR cessation on existing and new financial products and services they offer or distribute.*”

In Australia, the Australian Securities and Investments Commission (**ASIC**) have observed that sooner may not necessarily be better; firms should "*consider when the client is going to be most receptive to the information that they need to be given*".

3. RIGHT INFORMATION

And communications, of course, need to be clear, fair and not misleading.

Customer communications are an obvious area of litigation risk, including class action risk, and disclaimers will be of limited value in defending any claims.

Firms should be mindful of the asymmetry of information and potential conflicts of interest - plainly, banks will have access to greater information about relative liquidity in RFR and LIBOR products than most of their clients.

It is unlikely that a 'one size fits all' approach will be appropriate. In Singapore, the SC-STS has created client correspondence templates for banks to encourage consistency in their communication with individual clients.

Staff training is critical and firms should of course be mindful of whether they are providing information and education or advice.

4. RIGHT RATE

Fourthly, firms need to consider what the fair replacement rate is in the circumstances.

The UK FCA has said: *"LIBOR discontinuation should not be used to move customers with continuing contracts to replacement rates that are expected to be higher than what LIBOR would have been, or otherwise introduce inferior terms. We will pay close attention to any case where a contract amendment is made in this way as firms may be failing to meet their obligation to treat customers fairly."* However: *"When transitioning their existing contracts, firms receiving LIBOR-linked interest are not expected to give up the difference between LIBOR and SONIA, which results from the term credit risk premium that is built into the LIBOR rate, but not into SONIA."*

In Australia, ASIC has suggested that banks must make clear to customers what the likely cost of the transition to the right rate will be. Easier said than done when so much is unknown about how the rates will perform in the future.

Some comfort has been given by the FCA: "*Firms are more likely to be able to demonstrate they have fulfilled their duty to treat customers fairly where they adopt a replacement rate that aligns with the established market consensus, reached through appropriate consultation, and is recognised by relevant national working groups as an appropriate solution.*"

5. REMAINING CONTRACTS

It has long been recognised that, when we get to the end of 2021, there will be some LIBOR contracts still in play – the so-called "tough legacy" contracts.

This is clearly an area to keep an eye on as we move into 2021 – and the remaining uncertainty doesn't make the communication challenges, referenced above, any easier.

Progress is, however, being made – in the UK, at the time of writing, legislation is passing through Parliament (see here); trilogue discussions are taking place in relation to the European Commission's tough legacy proposal; and, in the US, the New York law proposal appears to be making some progress, and Federal level legislation seems to be a possibility as well.

That progress is tempered, however, by a lack of clarity as to how these 'tough legacy' proposals are intended to, or will, fit together.

6. RECORD KEEPING

We conclude with a reminder of the importance of record keeping.

As the FCA advises, firms should "*keep appropriate records of management meetings or committees that demonstrate they have acted with due skill, care and diligence in their overall approach to LIBOR transition and when making decisions impacting customers.*"

We would add that records of (i) processes used to identify contracts in scope and (ii) customer communications should also be retained.

This is an important area for any senior manager responsible for overseeing transition away from LIBOR - regulatory action and class actions are likely to focus primarily on the systemic nature of the bank's approach, making centralised documentation critical. But individual client communications are also relevant to demonstrating that the playbook has been followed.

... we recognise that some LIBOR contracts cannot be renegotiated in due time and that is why we are proposing new legal powers for the EU to replace the LIBOR with another benchmark ... We will ensure that EU contracts do not face a legal vacuum once LIBOR is phased out, thereby avoiding any risk to financial stability."

- Valdis Dombrovskis, European Commission

MORE FSR OUTLOOK 2021 ARTICLES

FSR Outlook 2021 main page

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

JENNY STAINSBY
GLOBAL HEAD – FINANCIAL SERVICES REGULATORY REGIONAL HEAD OF PRACTICE – DISPUTES, EMEA, LONDON
+44 20 7466 2995
Jenny.Stainsby@hsf.com

HARRY EDWARDS
PARTNER, MELBOURNE
+61 3 9288 1821
Harry.Edwards@hsf.com

HANNAH CASSIDY
PARTNER, HEAD OF FINANCIAL SERVICES REGULATORY, ASIA, HONG KONG
+852 21014133
Hannah.Cassidy@hsf.com

NATALIE CURTIS
PARTNER, SINGAPORE
+65 6868 9805
Natalie.Curtis@hsf.com

CERI MORGAN
PROFESSIONAL SUPPORT CONSULTANT, LONDON
+44 20 7466 2948
Ceri.Morgan@hsf.com

JOHN O'DONNELL
PARTNER, NEW YORK
+1 917 542 7809
John.ODonnell@hsf.com

PETER BEHMKE
PARTNER, NEW YORK
+1 917 542 7611
Peter.Behmke@hsf.com

ALEX HOKENSON
ASSOCIATE, NEW YORK
+1 917 542 7836
alex.hokenson@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.