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THE END IS NIGH – FCA ANNOUNCES END DATES FOR LIBOR

THE IMPACT ON EXISTING CONTRACTS

In 2018 the Financial Conduct Authority (FCA) announced that it would no longer compel panel banks to support the London Interbank Offered Rate (LIBOR) after the end of 2021. LIBOR is the benchmark rate, used worldwide since the 1970s, which underpins loans, bonds and derivative transactions with an estimated cumulative value of over £7 trillion. It is also regularly used as a benchmark rate in contracts for calculating default interest for late payment.

The challenge in replacing LIBOR is the volume of transactions and the complexity of the contracts covered. Moreover, the securitisation, bonds, loans and derivative markets are proposing solutions at different paces. Since its initial announcement, the FCA and other regulatory bodies have strongly advised against the continued use of LIBOR, and have pressed financial markets to move to alternative 'risk free' reference rates for both new contracts and existing (or 'legacy') contracts which reference LIBOR.

Notwithstanding the impact of Covid 19, the regulators have continued to apply pressure to adhere to this timetable. As we move into the final year of the publication of LIBOR, the pace and volume of regulatory announcements is increasing, with the definitive announcement of the end date for LIBOR in various currencies. Whilst regulators in different jurisdictions are moving at varying paces, this should not be a reason to delay taking action, as it looks inevitable that LIBOR will end.

The end of LIBOR

On 5 March 2021, the FCA announced that LIBOR rates published by ICE Benchmark Administration (IBA) would largely cease on 31 December 2021, with some rates potentially to continue to be published in a synthetic non-representative form for limited use in certain legacy contracts only (see table below). This announcement was supported by co-ordinated statements by IBA as well as the relevant US regulators and industry groups.

The 'synthetic LIBOR' rates will only be available for use with 'tough legacy' contracts expiring after 2021 which are particularly difficult to amend, for example because of the number of parties involved. The FCA has not yet published a definition of what will constitute a 'tough legacy' contract and continues to press parties to agree amendments to their existing contracts. Synthetic LIBOR will not be available for new lending. A 'synthetic LIBOR' rate will not be an exact economic substitute for the current LIBOR rates and there will inevitably be economic winners and losers in contracts which transition to synthetic rates, creating the risk of litigation. For this reason, the FCA and other regulators continue to advise parties to agree amendments to legacy contracts rather than gambling on a synthetic LIBOR solution and/or relying on proposed regulatory safe harbours.

Currency/tenor	Ends 31 Dec 2021	Ends 30 Jun 2023	Notes
GBP – overnight, 1 week, 2 and 12 month	✓		
GBP – 1, 3 and 6 month	✓		FCA to consult on continuation on synthetic basis for 'tough legacy' contracts for unspecified period
USD – 1 week and 2 month	✓		
USD – overnight and 12 month		✓	Parties can use these rates and extrapolate to determine rates for other tenors being discontinued. FCA considering continued publication of synthetic rate after June 2023.
USD – 1, 3 and 6 month		✓	FCA to consult on continuation on synthetic basis after 30 June 2023 taking into account views and evidence of US authorities and other stakeholders.
EUR – all tenors	✓		
CHF – all tenors	✓		
JPY – Spot next, 1 week, 2 and 12 month	✓		
JPY – 1, 3 and 6 month	✓		FCA to consult on requiring continued publication on synthetic basis until end 2022

What does this mean for contracts which have already been amended?

Many contracts have already been changed to include a ‘pre-cessation trigger’ that confirms that the LIBOR benchmark referenced in the contract will convert to an agreed fallback rate. Pre-cessation triggers are typically set in motion by an announcement by the benchmark administrator or regulatory authority that LIBOR will cease to be published or that LIBOR is no longer representative of the underlying market. Such contracts will move to the agreed fallback rate following the appropriate cessation date. Importantly for such contracts, the FCA has confirmed that it does not expect that any LIBOR settings will become unrepresentative before the intended cessation dates. The position will vary depending on whether contracts have been amended using suggested language provided by the Loan Market Association, or the US Alternative Rates Replacement Committee, or bespoke drafting.

What if the contract hasn’t been amended?

The pace of work to amend legacy contracts will increase significantly in 2021, particularly in relation to the LIBOR benchmarks which will end on 31 December 2021. Parties should review any such contracts and consult with counterparties to agree an approach to be taken. As explained above, hoping that a contract will fall within a potential ‘tough legacy contract’ definition could result in parties being placed in a worse position than a negotiated amendment to a replacement rate.

What about derivatives?

For derivatives subject to the either the ISDA Fallbacks Supplement (which, where incorporated, applies to derivatives contracts dated after 25 January 2021) or where the contracting parties signed up to the ISDA 2020 IBOR Fallbacks Protocol, the FCA announcement on 5 March was an index cessation event which fixes the date of change to the agreed fallback rate. Contracting parties also use derivatives to hedge interest rate risks in loan agreements, so they should check whether the fallback provisions in the derivatives align with or are complementary to that agreed for the loan agreements.

What if LIBOR is used purely as a default rate in a contract?

LIBOR was such a successful and versatile benchmark rate that it has been used far more widely than purely in financial transactions. It is used to calculate default interest rates in many commercial contracts. In such contracts it is highly unlikely that the risk free rates proposed to replace LIBOR in the various currencies would be appropriate replacements, since they require complex calculations and adjustment to replicate the effect of the forward-looking LIBOR rate. Parties will need to agree an appropriate solution, both for existing contracts which reference LIBOR in the calculation of default interest rates and for new contracts. As with financial contracts, there is no easy or obvious substitute. One possible alternative is to use a relevant central bank interest rate, with provision for a zero floor to address the risk of that rate turning negative.

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