KEY POINTS

- Following unexpected announcements on 30 November 2020, it now seems that publication of most USD LIBOR tenors (the world's most popular LIBORs) will not cease until June 2023 (at the earliest). Publication of other LIBORs are still scheduled to cease on 31 December 2021.
- By adhering to the ISDA 2020 IBOR Fallbacks Protocol (Protocol), many will find themselves locked into an interest rate risk that is unpracticable to hedge and/or to the shortcomings of SOFR when there may be a viable alternative.
- Under the Protocol, significant delay between an "Index Cessation Event" and "Index Cessation Effective Date" could, on current estimates, lead to windfalls globally for USD lenders (to the detriment of USD borrowers).
- Momentum is building towards using the ISDA method of converting LIBORs to RFRs not just for swaps but for all LIBOR-linked products. There is obvious merit in a significant proportion of LIBOR-linked products converting to rates based on the same methodology.
- The authors, however, do not see any obvious advantages in agreeing to future changes in contracts now.
- The extent to which entry from 2022 into new USD LIBOR transactions will be lawful or in accordance with regulatory expectations is unclear.
- Delay in cessation of USD LIBOR is also likely to cause further delay in adoption of new benchmarks in relation to IBORs linked to the USD.
- In the UK, the publication of the Financial Services Bill and the FCA's consultations of the exercise of its powers under the Bill have served to highlight the inconsistencies between the UK's and the European Commission's proposals, and therefore complexities and litigation that could arise from the operation of these parallel regimes.

Authors Justina Stewart, Chloë Bell and Hanif Virji

LIBOR transition: ISDA Protocol first mover disadvantage and other international perspectives

In this article, the authors consider some of the key international developments in Q4 2020 relating to LIBOR transition. They conclude that parties should exercise significant caution before signing up to the ISDA 2020 IBOR Fallbacks Protocol.

INTRODUCTION

Q4 2020 brought a deluge of LIBOR transition-related developments, including:

- **The Protocol:** On 23 October, ISDA's much awaited IBOR Fallbacks Supplement and Protocol were released.[1] The Supplement updates rate options in the 2006 ISDA Definition to include new risk-free rates (RFR) for five LIBOR rates plus eight IBOR benchmarks. The Protocol, which is effective on 25 January 2021, enables adhering parties to implement these RFRs into the terms of new transactions and to apply them to legacy contracts.
- **Delay in cessation of USD LIBORs:** On 30 November, in an event that took most of the market by surprise, ICE Benchmark Administration (the IBA), the authorised and regulated administrator of LIBOR, announced that it intended to delay until June 2023 cessation of publication of the most widely used tenors of USD LIBOR; the end 2021 date would, however, remain for other LIBORs. The FCA[2] and in the US, the Board of Governors of the Federal Reserve System the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the Agencies)[3] made simultaneous announcements supporting IBA's intentions. On 4 December, the IBA launched its consultation on these intentions.[4]
- **Financial Services Bill and FCA consultations:** On 21 October, in the UK, the Financial Services Bill was introduced to Parliament. This, if adopted, would amend the UK Benchmarks Regulation (which is essentially the EU Regulation 2016/1011 (EU BMR)). On 18 November, the FCA published consultations about its proposed policy in relation to its new powers under the Bill. These developments served to emphasise the inconsistencies between the UK's and the European Commission's (EU BMR Amendment Proposal) approach to LIBOR transition.[5]

In this article we focus on:

- under the Protocol, the interest rate risk brought about by the delay between an "Index Cessation Event" and "Index Cessation Effective Date", and potential, significant advantage to USD lenders (and corresponding detriment to USD borrowers);
- the IBA's, FCA's and the Agencies' announcements on the delay in cessation

of publication of the most widely used LIBORs globally;
- uncertainty following the announcements on the extent to which use of USD LIBOR in new transactions will be lawful or in compliance with regulatory expectations;
- the shortcomings of SOFR and an alternative;
- the interest rate risk in multi-currency products due to the staggered cessation of LIBORs;
- the impact of delay in USD LIBOR cessation on IBORs linked to the USD;
- the UK's and the European Commission's proposed regimes, and the inconsistencies between them.

ISDA 2020 IBOR FALLBACKS PROTOCOL

By adhering to the Protocol, the parties agree to amend legacy transactions such that in the event of an "Index Cessation Event" an RFR-based fallback applies to the transaction. The first fallback is to a:
- term adjusted RFR. A "backward shift" is applied to the calculation period, so amounts due are known at least two days in advance; *plus*
- a "spread adjustment". This is the median difference between the relevant IBOR and the daily compounded RFR over the past five years.

An "Index Cessation Event" is:
- a public statement or publication by or on behalf of the administrator that it has ceased or will cease to provide the relevant IBOR indefinitely or permanently and there is no successor administrator;
- a public statement or publication by a relevant body (eg a central bank for the relevant currency or a regulator) that the administrator will cease or has ceased to provide the rate indefinitely or permanently; or
- a "pre-cessation trigger", which applies only to LIBOR – a statement or publication by the FCA that the rate is or will become non-representative of the underlying market it is supposed to measure, that representativeness cannot be restored and the intention of the statement is to engage contractual fallback triggers.

By adhering to the Protocol, signatories have not just yielded control over rate and timing, but have also (save perhaps for major financial institutions) exposed themselves to basis risk exposure (the future difference between LIBOR and the RFR) that is impracticable to hedge.

That basis risk exposure is exacerbated by any delay between the Index Cessation Event and the "Index Cessation Effective Date". The latter is the date when the relevant rate actually stops being published or actually becomes non-representative. Delay between the Index Cessation Event and Effective Date seems inevitable. However, the extent of the delay remains unclear.

This (further) basis risk exposure arises from the fact that, under the Protocol, the "spread adjustment" is calculated at the time of the Index Cessation Event. However, it is not until the Index Cessation Effective Date that the parties apply the fallback rate to the transaction (between the Index Cessation Event and the Index Cessation Effective Date, it appears to be assumed that the parties continue to use the original IBOR).

Therefore, signatories to the Protocol could face the following scenario (among many others). The FCA announces in Q1 2021 that USD LIBOR will become non-representative in June 2023. Therefore, the spread adjustment is fixed in Q1 2021 using five-year historic data at Q1 2021. However, the spread adjustment is not applied to as transactions until June 2023, ie over two years later. The spread adjustment, had it been calculated as at June 2023, would be different, perhaps materially, to that calculated as at Q1 2021.

Consider an interest rate of *3-month USD LIBOR plus Margin* payable on a USD loan which will instead become *SOFR plus Margin plus spread adjustment* following the Index Cessation Effective Date (30 June 2023). The difference between USD LIBOR and SOFR has been on a downward path and with low interest rates generally expected to continue as a result of COVID-related economic pressures, this trend will likely persist. It follows that the five-year median of the difference will be lower the later the calculation is conducted. By one estimate the difference in the spread adjustment could be lower by around 0.1% for three-month USD LIBOR if the calculation is conducted in June 2023 rather than, say, February 2021. This would be to the detriment of all USD borrowers globally and given the size of indebtedness is in the trillions of dollars it will constitute a windfall for the lenders.

DELAY OF CESSATION OF WORLD'S MOST WIDELY USED LIBOR CURRENCY

Subject to any rights of the FCA to compel the IBA to continue publication, the IBA proposes the following LIBOR cessation dates:
- GBP LIBOR, EUR LIBOR, CHF LIBOR and JPY LIBOR (all settings), immediately following the LIBOR publication on 31 December 2021;
- USD LIBOR: 1 week and 2 months settings, also immediately following the LIBOR publication on 31 December 2021; but
- USD LIBOR: overnight and 1, 3, 6 and 12 months settings immediately following the LIBOR publication on 30 June 2023.

The IBA notes that "any publication of the Overnight and 1, 3, 6 and 12 Months USD LIBOR settings based on panel bank submissions beyond 31 December 2021 will need to comply with applicable regulations, including as to representativeness. Based on current information from panel banks, the IBA anticipates there being a representative panel for the continuation of these USD LIBOR settings through to June 30, 2023".

The IBA's proposed cessation dates were simultaneously endorsed by the FCA, and in the US by the Agencies. Whatever views one may have on the appropriateness of the cessation dates, at least this is evidence of some global co-ordination on LIBOR transition.

USE OF USD LIBOR IN NEW CONTRACTS DURING THE INTERIM PERIOD

It seems inevitable that some continued use of USD LIBOR in new contracts will be required. However, the extent to which entry from 2022 into new USD LIBOR transactions will be lawful or in accordance with regulatory expectations is unclear.

On 30 November 2020, the Agencies stated that they believed entering new contracts using USD LIBOR after 2021 would create safety and soundness risks, they "will examine bank practices accordingly" and they therefore encouraged banks to cease entering such contracts as soon as practicable and in any event by 31 December 2021. However, they also recognised that there may be limited circumstances when it would be appropriate for a bank to enter into new USD LIBOR contracts after this date, "such as":

- transactions executed for purposes of required participation in a central counterparty auction procedure in the case of a member default, including transactions to hedge the resulting USD LIBOR exposure;
- market making in support of client activity related to USD LIBOR transactions executed before 1 January 2022;
- transactions that reduce or hedge the bank's or any client of the bank's USD LIBOR exposure on contracts entered into before 1 January 2022; and
- novations of USD LIBOR transactions executed before 1 January 2022.

Therefore, the Agencies appear to view the 31 December 2021 end date for new USD LIBOR contracts as little more than a regulatory expectation. Further, the scenarios in which there would be lack of compliance with that regulatory expectation are (currently) not clearly defined.

However, the Agencies' views are only one piece of the jigsaw. USD LIBOR is determined by the IBA, which is regulated by the FCA. The FCA is currently subject to the EU BMR, although as discussed below, it is proposed that the FCA will be given new powers to address issues brought about by LIBOR transition. As also discussed below, those proposals are themselves inconsistent with the European Commission's proposals.

The FCA's approach to new contracts has thus far been somewhat different to the "soft" deadline/mere "regulatory expectation" indicated by the Agencies. On 4 December 2020,[6] Mr Schooling Latter stated that any final approach would be subject to a formal consultation (which has not yet been issued), and, importantly, highlighted the FCA's proposed new powers that would enable the FCA to restrict new use of a benchmark known to be ceasing (discussed further, below).

The FCA has stated that it would co-ordinate with the US authorities (and authorities in other jurisdictions) "to consider whether and if so how most appropriately to limit new use of USD LIBOR". We can but hope for a co-ordinated approach globally on the question of new contracts, and moreover that the details of this approach are disclosed in sufficient time to enable the market to prepare before the end of 2021.

THE PROTOCOL, SOFR AND THE ALTERNATIVE

Adherents to the Protocol are, in respect of US LIBOR, agreeing to SOFR as the relevant RFR.

SOFR's shortcomings are well-known; there is no term rate, and there is no credit component.

There is, however, an alternative. The US market is beginning to fracture with some of the smaller and community banks preferring to use the American interbank offered rate (Ameribor). The American Financial Exchange's (Ameribor's administrator) strategic alliance with Citibank is an indication that non-SOFR based term rates are likely to be a permanent feature of USD financings.

If this is so, then signing up to SOFR-based interest rates which either do not already exist or the terms of which are not fully known, does not seem sensible, particularly when it is entirely unnecessary to do so. It is difficult at present to see any advantage, but only disadvantage.

STAGGERED CESSATION: BASIS RISK

That USD LIBOR will stop being published on a different date to other IBORs is a cause of further uncertainty, due to basis risk. The full extent of the risk will become known when parties analyse their multi-currency products, and structured products in particular, in detail.

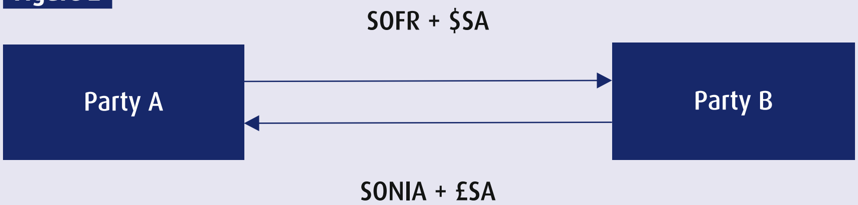
The example in Figure 1 below, involving a cross-currency basis swap, shows how this risk can arise.

A cross-currency basis swap is one where one party pays a variable rate of interest and receives a different variable rate in a different currency. For example, Party A pays 3-month USD LIBOR to Party B and Party B pays 3-month British pound (GBP) LIBOR to Party A.

Assuming, first, that USD LIBOR is replaced by SOFR plus USD spread adjustment ($SA) and GBP LIBOR is replaced with SONIA plus GBP spread adjustment (£SA), and, second, the transition for both currencies occurs simultaneously on 31 December 2021, the transaction is amended as follows in Figure 2 below.

Figure 1

Figure 2



Whatever misgivings the parties may have about the method employed to calculate the spread adjustment, ie five-year median difference between IBOR and compounded RFR, and the timing of the calculation, at least it will have been conducted on a consistent basis for both USD and GBP.

However, assuming that the proposals for staggered cessation dates for USD LIBOR and GBP LIBOR eventuates; first, for the period between 31 December 2021 and 30 June 2023, whilst the GBP leg of the swap will be linked to the GBP RFR, the USD leg will still be linked to USD LIBOR; second, the calculation of the spread adjustment for the USD is likely to be later than that for GBP (though the FCA could arrange matters so that the spread adjustments for USD LIBORs are calculated at the same time as for the other currencies, there has not been an announcement that that is their intention).

This means that both parties are exposed to basis risk which is difficult and unpracticable to hedge for most.

IMPACT OF DELAY ON IBORs LINKED TO USD

Delay to cessation in the publication of USD LIBOR is likely to cause a delay in adoption of new benchmarks in relation to IBORs linked to USD. This is particularly relevant to Middle Eastern and some Asian IBORs.

The central banks of many countries manage their currency exchange rates in relation to the USD. The International Monetary Fund has defined eight separate categories of currency exchange rate management strategies. These range from *independently floating* to a *currency board* – an explicit legislative commitment to a fixed exchange rate. Other arrangements are more complex where, for example, the exchange rate is freely floating within a band. Whatever the extent of the link between the currency and the USD, the link itself implies that their interest rates must also be linked.

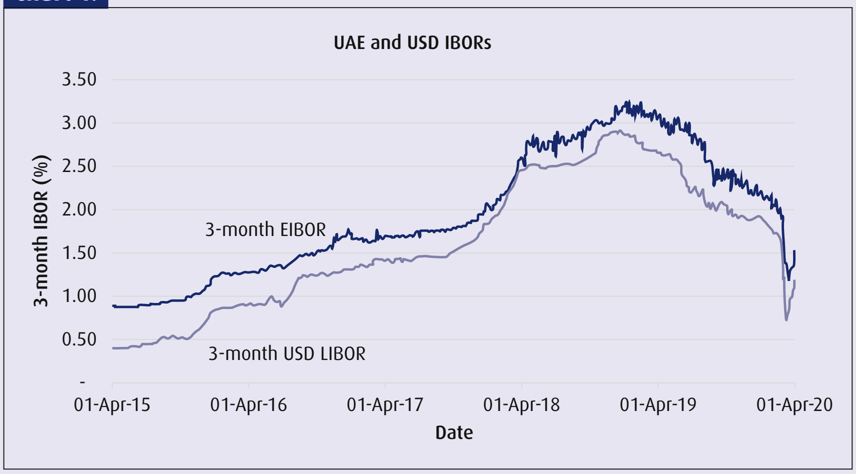
Countries in the Middle East tend to have a conventional fixed peg relationship with the USD, whether formal or *de facto*. Table 1 above provides examples of currencies and their IBORs.

TABLE 1:

COUNTRY	PEGGED EXCHANGE RATE VERSUS 1 USD	INTERBANK OFFERED RATE
Bahrain	0.376	BHIBOR
Jordan	0.710	JODIBOR
Kuwait[7]	0.310	KIBOR
Oman	0.385	OMIBOR
Qatar	3.640	QIBOR
Saudi Arabia	3.750	SAIBOR
United Arab Emirates (UAE)	3.673	EIBOR

Taking the UAE as an example, Chart 1 below shows the 3-month EIBOR and the 3-month USD LIBOR. It can be seen that the rates broadly track each other, with differences being linked to local factors.

Chart 1:



Given the strong links between Middle Eastern currencies and the USD, it follows that any delay in changing the USD benchmark interest rates will risk delays in amending the IBORs linked to USD currencies.

This is true not only in the Middle East but also for some Asian currencies with the Hong Kong dollar and the Singaporean dollar being particularly important. It had been planned to replace the Singapore Dollar Swap Offer Rate (SOR) with its RFR, the Singapore Overnight Rate Average (SORA), on 31 December 2021 with a suggested timetable to reduce exposure to 20% by Q3 2021. However, the calculation of SOR has an *explicit* link to USD LIBOR.[8] If the transition timetable is not amended to reflect the proposed change in the demise of USD LIBOR to 30 June 2023, a two-tier market is likely to develop: one based on SORA and the other based on SOR. Consequently, there will be winners and losers if the decision to convert automatically to SORA is made before all the details of the transition are known.

UK PROPOSED REGIME

On 23 June 2020, the Chancellor of the Exchequer made a statement reiterating that firms would be unable to rely on LIBOR after the end of 2021.[9] Mr Sunak encouraged firms to continue planning actively to transition their contracts away from LIBOR and announced a number of steps which would be taken by way of primary and secondary legislation to address "tough legacy" contracts that cannot transition from LIBOR. The statement indicated that legislation would

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be passed to ensure that the FCA's powers were sufficient to manage an orderly transition from LIBOR.[10] The relevant legislation, the Financial Services Bill 2020, is currently before Parliament. This includes a number of sections which will amend the UK's post-Brexit version of the EU Benchmark Regulation (UK BMR) and vest the FCA with conditional powers.[11]

On 18 November 2020 the FCA published consultations about its proposed policy in relation to the new powers that it would be granted under the Financial Services Bill.[12] The two most important provisions in the FCA's current consultation documents are the proposed new Arts 23A and 23D of the UK BMR.

Under Art 23A the FCA will have the power (after giving notice to the administrator of a critical benchmark) to designate a benchmark as an "Article 23A benchmark".[13] It will have the power to designate a benchmark as an Art 23A benchmark if its representativeness cannot reasonably be restored or maintained, or if the representativeness can be restored or maintained but there are not good reasons to do so. In order to designate a benchmark as an Art 23A benchmark the FCA is required to publish a Statement of Policy. The FCA has commenced its consultation on its proposed policy in respect of the designation of benchmarks under Art 23A.[14]

Following such designation there would be a general prohibition on usage of the benchmark by supervised entities albeit the FCA will have powers to exempt some or all existing use of the benchmark from this general prohibition.

In order to support the orderly wind-down of a benchmark, following a designation under Art 23A, the FCA will also have powers under Art 23D to modify a benchmark's methodology that could be used to sustain a benchmark for permitted legacy use, thereby preventing market disruption that may otherwise be caused by the collapse of a critical benchmark. The possible changes to the methodology envisaged include changes to the way in which the benchmark is determined, its input data, the rules of the benchmark and the code of conduct for submissions by contributors to the benchmark.[15]

There is some endorsement of ISDA's methodological approach to approximate the value of an IBOR for legacy use by the FCA. In its consultation on Art 23D the FCA referenced ISDA using a five-year historical median of the difference in rates between the relevant IBOR and relevant RFRs, which is then added to the RFR and stated that "our provisional view is that this is a fair and robust way of approximating the outcome delivered by LIBOR".[16] Whether that provisional view becomes part of the FCA's policy will only be clear following its consultation.

The FCA is only able to exercise its Art 23D power if it considers it appropriate to do so having regard to the desirability of securing that the cessation of the benchmark takes place in an orderly fashion and if it is desirable to advance an appropriate degree of protection for consumers and enhancing the integrity of the UK financial system.

The FCA has indicated that it is likely to consider a disorderly cessation to include situations where a critical benchmark ceases in a way which leaves significant numbers of market participants unlikely to be able to agree how obligations determined by reference to the benchmark can be fulfilled or means that market participants' ability to manage risks is seriously impaired. The risks of a disorderly transition are therefore likely to be more acute where there are significant numbers of contracts that cannot reasonably be converted to reference alternative benchmarks through sufficiently timely action or agreement by parties to those contracts.[17] These are essentially "tough legacy" contracts, the definition of which will be subject to the outcome of the FCA's consultation on Art 23D.[18]

EU PROPOSED REGIME

EU legislation which comes into effect after the end of the Brexit Transition Period will not be "onshored" in the UK. This includes legislative steps being considered in the EU to mitigate uncertainties in the context of LIBOR transition.

In July 2020 the European Commission published a proposal for a regulation to amend the BMR[19] so as to facilitate the exemption of certain Third Country foreign exchange benchmarks and the designation of replacement benchmarks.[20] The EU BMR Amendment Proposal gives the European Commission the power to designate a statutory successor for a benchmark whose permanent discontinuation would result in significant disruption in the functioning of financial markets in the EU.

In selecting the statutory replacement rate the European Commission must take into account recommendations made by RFR working groups convened by the central banks for each LIBOR currency (eg the Sterling Risk-Free Rate Working Group in the UK).

Proposed Art 23a(1) of the EU BMR states that the Commission may designate a replacement benchmark in three trigger situations:

- a public statement by or on behalf of the administrator of a benchmark announcing that the administrator has ceased or will cease to provide the benchmark permanently;
- a public statement by the regulatory authority competent for the authorisation of the administrator of the benchmark announcing that the administrator of a benchmark has ceased or will cease to provide the benchmark permanently;
- a public statement by the regulatory authority competent for the authorisation of the administrator of the benchmark announcing that the benchmark is no longer representative of an underlying market or economic reality on a permanent and irremediable basis.[21]

The European Commission's proposal makes clear that the scope of the statutory replacement rate is "all contracts referencing a benchmark in cessation that involve an EU supervised entity as a counterpart".[22] Recital 9 of the proposal states that use of the replacement benchmark should be allowed only for contracts that have not been renegotiated prior to the cessation date of the benchmark concerned. It will not be available for contracts entered into subsequent to the entry into force of the statutory replacement rate. It should not be used for contracts that already provide a suitable contractual fallback provision.

It also allows supervised entities to "opt-out" of the statutory replacement benchmarks where they have renegotiated their references to a benchmark and selected another replacement rate.[23]

Proposed Art 23a(2) states that the replacement benchmark "shall by operation of law" (ie mandatorily) replace all references to the benchmark which have ceased to be published in financial instruments, financial contracts

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and measurements of the performance of an investment fund involving EU supervised entities where all of the following conditions are fulfilled:

- those financial instruments, contracts and performance measurements reference the benchmark that has ceased to be published on the date the Commission designated replacement benchmark enters into force; and
- those financial instruments, contracts or performance measurements contain no suitable fallback provisions.

The Commission has also been given the power to invite member states to complement the EU statutory replacement rate with national statutes mandating the use of the EU successor rate in contracts between non-financial counterparts that are governed by the laws of their jurisdiction and which fall outside of the scope of the EU BMR.

The draft legislation was not passed before the end of the Brexit transition period. It will therefore not be automatically "onshored" in the UK. UK supervised entities will therefore not be subject to this regime, except insofar as they are party to contracts with EU supervised entities. Insofar as they are party to contracts with EU supervised entities, it is unclear how the UK and EU regimes will work together and, to the extent there are inconsistencies between the two regimes, whether there is to be a hierarchy or primacy of one over the other. See further, below.

INCONSISTENCIES BETWEEN THE EU AND UK POSITIONS AND ASSOCIATED LITIGATION RISK

The scope of the UK and EU regimes will be different, with the UK regime only applying to "tough legacy" contracts, which have not yet been defined, but which Mr Sunak indicated would be a "narrow pool" whereas the EU regime will apply to all legacy contracts falling within the EU BMR meeting set criteria (eg no, or no suitable fallback provisions). The European Commission has also indicated in its proposals that optional use will be possible for legacy contracts which provide parties with a choice of fall-back rates and legacy contracts that do not involve a supervised entity within the scope of the EU BMR.[24] This is likely to give rise to complexities in interpreting the operation of these two parallel regimes.

It is also unclear how the EU's proposal of a statutory replacement rate will interact with the UK's proposal for a change in methodology and the production of a "synthetic LIBOR" for tough legacy contracts. This has been recognised by the FMLC which stated in its recent paper[25] that it is possible that LIBOR might both have been discontinued – triggering the Commission's powers to designate a statutory replacement benchmark for the purposes of the EU amended BMR – and preserved in the sense that the IBA has been required by the FCA to produce a synthetic benchmark. This was also mentioned by the FMLC in its response to the European Commission's proposal for amendments to the EU BMR.[26] The authors of that paper state that there is therefore a real potential of conflict and overlap, with which we agree.[27] For example, if the synthetic screen rate is different from the statutory replacement rate, then in contracts involving EU and UK supervised entities, it is far from clear which rate should apply.

Similarly, if a product which is subject to one regime but is hedged by a contract which is subject to a different regime, there is the potential for different successor rates to apply under the EU and UK regimes.

In the case of cross-border contracts, the question of what the terms of the contract mean are normally decided according to the governing law of the contract.[28] On that basis, where a contract is governed by English law the EU statutory replacement rate will not be incorporated into a contract even where an EU supervised entity is a counterparty. It is unclear how EU institutions will react to this where the statutory replacement rate is meant to be mandatorily incorporated into a contract pursuant to the amended EU BMR.

The EU's legislative proposal does not explain what replacement "by operation of law" means. On its face, the EU solution will apply directly to any contract which falls within the scope of the BMR which references LIBOR and involves an EU-supervised entity, regardless of the law of the contract itself. There may be some confusion as to whether the new provisions of the EU BMR impliedly derogate from the choice of law rules under Art 12 of the Rome I Regulation.[29] Indeed, it might be argued that the Commission's statutory replacement rate constitutes an overriding mandatory provision of EU law under Art 9(2) of Rome I, as a result of its importance to the economic stability of the EU, and apply irrespective of the parties' choice of law. It is therefore uncertain which regime will apply and/or trump the other, especially if the successor rates adopted by the UK and EU proposals are not the same.[30]

If the successor rates are the same, then many of these potential difficulties fall away. The FCA has made it clear that it has taken a favourable provisional view of the methodology which has been adopted by ISDA (see above). The FCA has specifically stated at para 2.16 of its consultation on Art 23D that in considering cessation in an orderly fashion it may have regard to the situation outside the UK. It has therefore extended its engagement and consultation processes outside the UK.[31] The European Commission has also stated in its proposal that it "shall take into account the recommendations of the risk-free rate working groups operating under the auspices of the central banks responsible for the currency in which the rates of the benchmark in cessation are denominated".[32] It remains to be seen to what extent the UK and EU regulators will align on this issue.

However, the uncertainty and potential for litigation arising from inconsistencies is compounded by the need to "wait and see" the outcome of consultations with market participants and working groups and the successor rates ultimately produced by the respective regimes.

In addition to the potential for inconsistency and overlap between the UK and EU regimes, neither regime contains any mechanism for compensating individuals who suffer a transfer of wealth as a result of the change in the benchmark rate. Our view is that the lack of such a mechanism is likely to increase litigation risk in the event of conflict or inconsistency between the two regimes. As expressed in a previous article, John McKendrick QC, Justina Stewart and Chloë Bell, 'The UK's announcement of plans for a synthetic LIBOR: panacea or pandora's box?' (2020) 8 JIBFL 517, we also consider that the lack of such a mechanism will exacerbate the risk of public law challenges in the UK.[33]

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CONCLUSION

In light of the challenges brought about by COVID-19, the progress on LIBOR transition during 2020 has been impressive. Momentum towards using the ISDA methodology of converting LIBORs to RFRs is growing.

However, extensive uncertainty remains. Sufficient liquidity in underlying RFRs and suitable term rates must still be established. The timings of Index Cessation Events and Index Cessation Effective Dates under the Protocol are unknown. This compounds uncertainty brought about by apparently different legislative approaches, and most recently the announcements regarding staggered cessation dates between the world's most commonly used LIBOR tenors, and other LIBORs.

In view of such uncertainty and risks, parties should exercise considerable caution before signing up to the Protocol. The authors do not see any obvious advantage in agreeing to future changes in contracts now. For example, if the official spread adjustment is calculated in, say, Q1 2021 and by December 2021 it is lower, then borrowers who have not pre-agreed the change can negotiate a lower rate. Conversely, if it is higher, then the official ISDA calculation will typically be available. As such, it could be said that the current modus operandi gives a "free option" to those who do not sign the Protocol and its equivalents in other markets. ■

1 https://www.isda.org/2020/10/23/isda-launches-ibor-fallbacks-supplement-and-protocol/

2 https://www.fca.org.uk/news/statements/fca-response-iba-proposed-consultation-intention-cease-us-dollar-libor

3 https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf

4 https://www.theice.com/publicdocs/ICE_LIBOR_Consultation_on_Potential_Cessation.pdf

5 On 28 October 2020, the New York State Senate introduced a Bill which, if adopted would amend the Uniform Commercial Code by introducing new statutory provisions that would apply if USD LIBOR was discontinued or ceased to be representative. The proposals largely replicate those of the Alternative Reference Rate Committee. US legislative developments are outside the scope of this article.

6 http://assets.isda.org/media/f1a442f2/80e230bf-pdf/

7 The Kuwaiti dinar is pegged to a basket of currencies dominated by the USD.

8 Paragraph E, p 9, https://www.abs.org.sg/docs/library/calculation-methodology-abs-benchmarks.pdf

9 Rishi Sunak (The Chancellor of the Exchequer), Financial Services Regulation: Written statement - HCWS307, (23 June 2020), available at: https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS307.

10 The Financial Services Bill which was introduced to Parliament on 21 October 2020 would amend the Benchmarks Regulation which is essentially the EU Regulation 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and was brought onshore under the European Union (Withdrawal) Act 2018.

11 https://services.parliament.uk/Bills/2019-21/financialservices/documents.html. See also the Benchmarks Regulation 2016/1011 as amended by the Benchmarks (Amendment) (EU Exit) Regulations 2019.

12 https://www.fca.org.uk/news/statements/fca-consults-on-new-benchmark-powers.

13 See s 13 of the Financial Services Bill, as introduced to Parliament on 4 October 2020.

14 https://www.fca.org.uk/publication/policy/consultation-designation-benchmarks-new-article-23a.pdf, the new Art 23F(1)(b) of the UK BMR.

15 See new Art 23D(2), contained in s 15 of the Financial Services Bill.

16 https://www.fca.org.uk/publication/policy/consultation-exercise-fca-powers-new-article-23d.pdf, para 1.12.

17 https://www.fca.org.uk/publication/policy/consultation-exercise-fca-powers-new-article-23d.pdf, para 2.6.

18 https://www.fca.org.uk/publication/policy/consultation-exercise-fca-powers-new-article-23d.pdf, para 2.7-2.12.

19 Regulation 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (2016) OJ L-171/1 (EU BMR).

20 European Commission, Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation (24 July 2020), available at: https://ec.europa.eu/finance/docs/law/200724-benchmarks-review-proposal_en.pdf.

21 See European Commission Proposal, p 12.

22 See European Commission Proposal, p 12.

23 See European Commission Proposal, p 12.

24 See European Commission Proposal, p 12.

25 http://fmlc.org/wp-content/uploads/2020/10/FMLC-LIBOR-Transition-FINAL.pdf, para 3.3.

26 http://fmlc.org/wp-content/uploads/2020/10/FMLC-Response-to-Proposal-to-amend-the-BMR.pdf.

27 See para 3.3.

28 See Art 3 of the Rome I Regulation (EC) No 593/2008 on the law applicable to contractual obligations which will apply in much the same way post Brexit. See Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc.) (EU Exit) Regulations 2019 which will come into force at the end of the transition period.

29 Regulation (EC) No 593/2008 on the law applicable to contractual obligations. See also http://fmlc.org/wp-content/uploads/2020/10/FMLC-LIBOR-Transition-FINAL.pdf, para 4.19.

30 This has been raised by Herbert Smith Freehills in the following article: https://hsfnotes.com/bankinglitigation/2020/07/31/legislating-for-libor-transition-uk-eu-jurisdictional-battle-or-complementary-regimes/.

31 https://www.fca.org.uk/publication/policy/consultation-exercise-fca-powers-new-article-23d.pdf.

32 European Commission Proposal, p 11.

33 See also references to potential human rights challenges by the FMLC in its paper in relation to legislative solutions: http://fmlc.org/wp-content/uploads/2020/10/FMLC-LIBOR-Transition-FINAL.pdf, para 4.8.