Sound Bites Series: FCA statement on LIBOR discontinuation

March 11, 2021

As the phasing out of LIBOR and its replacement with risk free rates (RFRs) continues to be a hot topic, the Financial Conduct Authority (FCA) published a further update on 5 March 2021 (available here). In summary, this confirmed, among other things, the future cessation or loss of representativeness of all 35 LIBOR settings currently published by ICE Benchmark Administration Limited.

Why is this relevant to banks/corporates in the Middle East?

This may impact a number of financial products (for instance, loans and derivatives), in particular because US dollar denominated financial products entered into by banks and corporates in the Middle East commonly use US dollar LIBOR as a benchmark in calculating interest or, in an Islamic context, the profit rate. The 26 LIBOR settings to cease permanently also include:

- Immediately after 31 December 2021: the 1-week and 2-month US dollar LIBOR settings; and
- Immediately after 30 June 2023: the overnight and 12-month US dollar LIBOR settings.

The FCA will also consider whether to require IBA to continue publishing 1-month, 3-month and 6-month US dollar LIBOR on a non-representative, synthetic basis for a further period after the end of June 2023. These settings will no longer be representative and representativeness will not be restored immediately after 30 June 2023. Although publication of certain LIBOR settings on a synthetic basis would be intended to assist legacy contracts, new use of this synthetic LIBOR by UK-regulated firms in regulated financial instruments would be prohibited by the BMR as amended by the Financial Services Bill.

Immediate practical significance

Accordingly, we share with you four points on the immediate practical significance of this for finance documents (whether structured on a conventional or Islamic basis) that are useful to bear in mind (noting that points 1 and 2 are probably the key points for present purposes, although points 3 and 4 may also be of relevance depending on the terms of the finance documents entered into recently):

1. Only Majority Lender/Majority Participant consent required to amend interest/profit rate related provisions in US dollar LIBOR based facilities with replacement screen rate clauses

A "Screen Rate Replacement Event" will have occurred under some existing LIBOR-based syndicated facility agreements/finance documents. Note, in particular, the following two limbs of the current LMA definition:

1. "the supervisor of the administrator of the Screen Rate publicly announces that such Screen Rate has been or will be permanently or indefinitely discontinued;"
2. "in the case of [a Screen Rate for LIBOR], the supervisor of the administrator of that Screen Rate makes a public announcement or publishes information…stating that that Screen Rate is no longer or, as of a specified future date will no longer be, representative of the underlying market or economic reality that it is intended to measure and that representativeness will not be restored (as determined by such supervisor)." (However, note that this limb was only suggested by the LMA in October 2020, so is unlikely to be in many agreements.)

Where a Screen Rate Replacement Event has occurred, interest/profit rate related amendments can be made with Majority Lender/Majority Participant, rather than all Lender/all Participant, consent.

2. Greater certainty regarding cessation of US dollar LIBOR on 30 June 2023

Though it has been anticipated since November 2020 that US dollar LIBOR will continue to be published in all the key tenors until the end of June 2023, this announcement provides further comfort that that will indeed be the case.

3. In any existing switch facility, a "Rate Switch Trigger Event" is likely to have occurred

However, that does not mean that the switch from LIBOR to RFRs will have automatically occurred. On the basis of the LMA exposure drafts, the "Rate Switch Trigger Event Date" on account of the "Rate Switch Trigger Event" will be the date of anticipated discontinuation/non-representativeness, rather than 5 March 2021. Switch facilities are expected to switch on the "Backstop Rate Switch Date", specified in the agreement.

4. On new switch or RFR-based facilities, there should no longer be any debate about how the credit adjustment spread is calculated, or when

One would expect new facility agreements that include a credit adjustment spread to simply refer to the relevant "official" credit adjustment spreads calculated and published by Bloomberg on 5 March 2021 for the purposes of ISDA fallbacks (available here), rather than include a methodology to calculate the spread at a later date.

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