

Tough legacy legislative proposals: a snapshot

The challenges associated with transitioning legacy LIBOR bonds and certain other types of legacy LIBOR instruments to alternative risk-free rates are now well

known¹, and authorities and official sector-sponsored working groups in a number of jurisdictions have been focusing on this issue. Set out below is a high-level snapshot of the legislative proposals that have been put forward in the US, EU and UK to address this issue.²

Status in September 2020

| US | EU | UK |
|--|--|---|
| The Alternative Reference Rates Committee (ARRC) published a proposal for New York State legislation in March 2020. It is not clear whether or when the ARRC's proposal will be implemented into New York State law. | The European Commission published a proposal for amendments to the EU Benchmarks Regulation in the context of LIBOR cessation in July 2020. It is understood that EU co-legislators are considering this proposal and there is a desire to move quickly. | HM Treasury issued a written statement in June 2020 stating that it intends to amend the UK's existing regulatory framework for benchmarks in the forthcoming UK Financial Services Bill. The FCA issued a related statement and Q&A on the same day. |

General approach

| US | EU | UK |
|---|---|---|
| Broadly speaking, the ARRC proposal involves: (1) a statutory override of certain types of fallbacks in legacy USD-LIBOR contracts, securities and instruments by an ARRC-recommended replacement rate and credit adjustment spread upon the occurrence of certain statutory trigger events; (2) a statutory safe harbour for the use of such ARRC-recommended replacement rate and credit adjustment spread; and (3) a statutory safe harbour for parties who add conforming changes to their documents to accommodate administrative/operational adjustments to reflect the application of the statute. | Broadly speaking, the European Commission's proposal involves a statutory override of certain types of fallbacks in legacy contracts by a replacement rate selected by the European Commission pursuant to new powers under the EU Benchmarks Regulation which are triggered upon the occurrence of certain statutory trigger events. | Broadly speaking, HMT's proposal involves empowering the FCA to direct the administrator of a relevant benchmark (eg LIBOR) to change the methodology used to compile the benchmark in certain circumstances. |

1. See [previous editions](#) of this ICMA Quarterly Report for a discussion of the issues surrounding legacy LIBOR bonds, including the most recent [Third Quarter 2020 edition](#).

2. A more fulsome discussion of the US and UK proposals can be found in [From LIBOR to SONIA in the Bond Market](#), Paul Richards, ICMA, July 2020.

Scope

| US | EU | UK |
|---|---|--|
| <p>The ARRC's proposed New York State legislation, as drafted, is expected to apply on a mandatory basis to contracts, securities or instruments governed by New York law, referencing USD-LIBOR, with either no fallback or a fallback to a LIBOR-based rate, upon the occurrence of certain statutory trigger events. The statute would not override legacy language that falls back to an express non-LIBOR based rate (such as Prime). If an in-scope contract, security or instrument gives a party the right to exercise discretion or judgment regarding the fallback, that party can decide whether to avail itself of a statutory safe harbour for use of the ARRC-recommended replacement rate and credit adjustment spread. Parties would be permitted to mutually opt out of the application of the statute, in writing, at any time before or after the occurrence of a trigger event.</p> | <p>While the European Commission's proposal was made with LIBOR cessation in mind³, the proposal has been drafted in a manner that could apply in the context of cessation of any benchmark where there may be significant disruption in the functioning of financial markets in the EU.</p> <p>It is not yet clear whether the amendments to the EU Benchmarks Regulation will relate to any contract, security or instrument referencing the relevant benchmark, or a more narrow sub-set of such contracts, securities or instruments. ICMA understands that, as a matter of law, it seems likely that EU legislation could only override contracts governed by the law of an EU Member State.</p> <p>The European Commission's proposal, as drafted, applies where the relevant contract or instrument contains no "suitable" fallback provisions. The precise meaning of this is not clear, and it is hoped that this aspect of the European Commission's proposal will be clarified during the trilogue process.</p> | <p>HM Treasury's written statement also references LIBOR cessation, but the proposed FCA powers to require modification of a benchmark's methodology would apply in relation to any critical benchmark in circumstances where the regulator has found that the benchmark's representativeness will not be restored and where action is necessary to protect consumers and/or to ensure market integrity.</p> <p>In its Q&A, the FCA notes that the use of these powers might not be possible in all circumstances or for all LIBOR currencies, for example where the inputs necessary for an alternative methodology are not available in the relevant currency. For this and other reasons, the FCA and other authorities have been clear that those who can amend their contracts so that they move away from LIBOR should do so.</p> <p>It is not yet clear whether any "modified" version of LIBOR would be available to any contract, security or instrument referencing LIBOR, or only a sub-set of such contracts, securities or instruments. The FCA has stated that the proposed changes will create a possible way of reducing disruption to holders of "tough legacy" LIBOR contracts (ie contracts that genuinely have no or inappropriate alternatives and no realistic ability to be renegotiated or amended).</p> |

Conclusion

It will be interesting to see how the US, EU and UK legislative proposals progress and what changes (if any) will be made before they are finalised and enshrined in law. Market participants in the international bond market will be looking for certainty and clarity on the scope of the relevant legislative provisions so that it is clear how the different statutes interact with each other and which statute applies in which circumstances. It also remains to be seen whether the different proposed approaches will

result in the same rate and credit adjustment spread being applied to in-scope contracts, securities and instruments, but via different means. ICMA will be monitoring developments closely and continuing to engage with members and authorities on this important issue for the international bond market.

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3. See press release entitled [Financial Stability: Commission Addresses Risks of LIBOR Cessation](#), 24 July 2020