Linklaters

Happy New Year! – And happy first London Banking Day after 1 January 2022!
4 January 2022

The end of 2021 marked the end, to most intents and purposes, of LIBOR. Once considered so unassailable that few, if any, agreements contemplated its permanent cessation and the initial suggestions of its demise met with incredulity. Here's a snapshot of what you need to know.

What just happened to LIBOR?
In accordance with the FCA announcement of 5 March 2021, publication of the LIBOR settings listed in the table below either **ceased**, or became **unrepresentative**[1], immediately after 31 December 2021:

	LIBOR settings for which publication ceased immediately after 31 December 2021	LIBOR settings which became unrepresentative immediately after 31 December 2021
CHF	All seven **CHF LIBOR** settings	
EUR	All seven **EUR LIBOR** settings	
GBP	Overnight, 1-week, 2-month and 12-month **GBP LIBOR** settings	1-month, 3-month and 6-month **GBP LIBOR** settings
JPY	Spot Next, 1-week, 2-month and 12-month **JPY LIBOR** settings	1-month, 3-month and 6-month **JPY LIBOR** settings
USD	1-week and 2-month **USD LIBOR** settings	

What is still to come?
A longer period has been allowed for the wind-down of the remaining US dollar LIBOR settings, such that immediately after **30 June 2023**:

> publication of overnight and 12-month USD LIBOR will **cease**; and

> 1-month, 3-month and 6-month USD LIBOR will cease to be provided or potentially, subject to consultation by the FCA, be provided on a synthetic basis and therefore become **unrepresentative**.

What does this mean for ISDA's new fallbacks?
ISDA has improved fallbacks for LIBOR. These were automatically applied for trades entered into from 25 January 2021 by virtue of Supplement 70 to the ISDA 2006 Definitions, which, in turn, were capable of applying to legacy positions by virtue of adherence to the ISDA 2020 IBOR Fallbacks Protocol (the **Protocol**). This is not to be confused with the ISDA 2021 IBOR Fallbacks Protocol, which in its first module includes enhanced fallbacks for an additional range of term interest rates (IBORs in India (MIFOR), Malaysia (KLIBOR), New Zealand (BKBM), Norway (NIBOR), the Philippines (PHIREF) and Sweden (STIBOR)). The enhanced fallbacks were also included in the ISDA 2021 Interest Rate Derivatives Definitions.

How does the fallback rate work?
The fallback rates published by Bloomberg are an "all-in" fallback rate that comprises a compounded overnight rate with a two day backward shift and a fixed spread representing the five year historic median difference between the relevant RFR and IBOR rate. In the case of LIBOR, the spreads were fixed on 5 March 2021 upon the FCA's announcement. The Bloomberg Technical Notice – Spread Fixing Event for LIBOR sets out these fixed spreads.

Unlike with a term rate, the fallback rate is effectively sourced two payment Business Days prior to the relevant Payment Date. This will be a significant change once the fallback rates apply.

The first day on which the fallback rates could be applied to a contract is the first London Banking Day after 1 January 2022.

Does that mean the fallback rates apply immediately?
Not necessarily. Where incorporated, the ISDA IBOR fallback rates will apply from the first reset date after the fallback became applicable. For example, where the reset date is "… the first Business Day of each March, June, September and December…", the ISDA IBOR fallback rate will apply from the Reset Date in March 2022. This means that there is no need to try to split a Calculation Period to apply the LIBOR rate through to 4 January 2022 and the fallback rate thereafter.

[1] The FCA has exercised its powers under the UK Benchmark Regulation to compel continued publication of these LIBOR settings on a "synthetic" basis for a limited period, see further below.

Do confirmations need to be amended to reflect the new fallback rate under the relevant ISDA IBOR fallback?

No, where ISDA IBOR fallbacks are incorporated, the fallback rates apply automatically and no change to confirmations is required. This is because the definition of the floating rate option itself includes the various fallback provisions.

Is it just my derivative contracts that are caught by the Protocol?

No, the Protocol covers a wider range of agreements, including specified ISDA Master Agreements and ISDA Credit Support Documents as well as non-ISDA master agreements, such as the GMRA and GMSLA, and credit support documents. This means that if you have adhered to the Protocol, you should know which of your underlying agreements have been amended by it.

What about cleared derivative positions?

LCH, CME and Eurex have played an important role in supporting transition to RFRs through mandatory contractual conversion of those legacy contracts referencing rates that have now ceased, or become unrepresentative, to the respective fallback RFRs, ahead of end-2021.

What about synthetic LIBOR?

Synthetic LIBOR will not be relevant to derivative transactions where the enhanced ISDA IBOR fallbacks, or equivalent provisions which include a “pre-cessation trigger”, apply.

The FCA has exercised its power under the UK Benchmark Regulation to compel ICE Benchmark Administration (IBA) to publish 1-month, 3-month and 6-month GBP and JPY LIBOR settings under a changed “synthetic” methodology from 1 January 2022 for a limited period. This “synthetic” methodology is based on the relevant forward-looking term RFRs and the ISDA spread adjustments for the relevant LIBOR setting. The FCA has confirmed that use of the six synthetic LIBOR settings by supervised entities will be permitted for all **legacy transactions**, other than (directly or indirectly) cleared derivatives.

Synthetic JPY LIBOR will be published for 12 months only. For the three sterling LIBOR settings, the FCA will review, and potentially renew, the requirement for continued publication of some, or all, of those settings for a further 12 months before the end of 2022.

Under the UK Benchmark Regulation, the FCA can undertake this annual review for a maximum of period of 10 years from end-2021. The FCA has noted, however, that intends to use these powers for no longer than necessary to ensure an orderly wind-down of LIBOR.

Together with the Critical Benchmarks (References and Administrators’ Liability) Act 2021, synthetic LIBOR is intended to smooth the cliff edge for legacy transactions and allow additional time for active transition to RFRs. However, the FCA has emphasised that synthetic LIBOR is not a permanent solution. This means that there is still merit in adopting the ISDA fallbacks or otherwise transitioning the position to an alternative rate.

Can we expect the FCA to exercise its power to compel publication of synthetic LIBOR for 1-month, 3-month and 6-month USD LIBOR settings post-30 June 2023?

The FCA is expected to consult on this during the course of 2022 and has cautioned against making any assumptions based on its decisions regarding synthetic LIBOR to date.

Given the longer wind-down period, can I continue to use the remaining five US dollar LIBOR settings as usual until 30 June 2023?

As a general rule, no. Regulators in the UK, US and in other jurisdictions have called for market participants to cease entering into new contracts that reference USD LIBOR by end-2021.

In the UK, use of these rates by supervised entities is prohibited in new contracts written after 31 December 2021 under the UK Benchmark Regulation, unless they fall within one of a limited set of exceptions.

And what about EONIA?

EONIA was published for the final time on 3 January 2022. Prior to cessation, the Working Group on Euro Risk-free Rates recommended that market participants transition to €STR and that a fallback to €STR + 8.5 basis points be incorporated into those contracts continuing to reference EONIA. ISDA has supported these recommendations through publication of bilateral template amendment agreements and ISDA 2021 EONIA Collateral Agreement Fallbacks Protocol.

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