

SYNTHETIC LIBOR AND THE UK CRITICAL BENCHMARKS (REFERENCES AND ADMINISTRATORS' LIABILITY) ACT 2021: 10 THINGS THAT YOU NEED TO KNOW

With a matter of weeks to go, the UK legislation to address contract continuity for contracts relying on synthetic LIBOR after 31 December has now received Royal Assent.

This quick overview might help your assessment of the Critical Benchmarks (References and Administrators' Liability) Act 2021 – especially given that the UK legislative approach (with its reliance on continued use of a forward-looking rate, albeit on a modified and temporary basis) differs from the statutory replacement approach adopted by the EU and the United States.

Synthetic LIBOR is limited to three Sterling LIBOR and Japanese Yen LIBOR settings (one-, three- and six-month) and will be short-term, with a maximum of 10 years for Sterling (with an annual review) and one year only for Yen. The relevant spread adjustments were announced on 5 March 2021 by ISDA and are also listed on this ICE 19 November 2021 release. It is likely, however, that synthetic LIBOR will appear as one amount (rate + spread), on the same screen page and at the same time on which the relevant LIBOR currently appears.

This short summary does not contain any detailed analysis or consider the consequences of synthetic LIBOR ceasing. In addition, local law advice should be sought on whether a contract governed by non-English law continues with synthetic LIBOR. We would however be happy to advise on any questions. Feel free to contact any one of us or speak with your usual Clifford Chance contact.

Scope

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| 1. Applies to contracts or arrangements, whenever formed, made under the laws of England and Wales, Scotland or Northern Ireland. | See Article 23FA(4)(a), Section 3, |
| 2. Makes changes to the UK Benchmarks Regulation (UK BMR), but the continuity provisions apply to ALL contracts and arrangements. | Section 4 |

(It is important to distinguish the scope of the Act from the UK FCA's separate determination on tough legacy permitted use. The UK FCA's determination is relevant only for "use" for UK BMR purposes – although in its draft 16 November 2021 Notice, the UK FCA proposes to allow UK BMR broad "use", initially, for all products other than cleared derivatives.)

Contract continuity	
<p>3. Provides that references to LIBOR in relevant English law contracts or "arrangements" will be interpreted as including references to synthetic LIBOR.</p> <p>Moreover, the Act provides that a contract is to be treated as having always provided for the reference to the benchmark to be interpreted as the synthetic benchmark, once introduced.</p>	<p>See Article 23FA(1) and Article 23FA(5)</p>
LIBOR references	
<p>4. Broad drafting in the Act attempts to catch all references to FCA designated benchmarks and indices, however drafted – but you will, nonetheless, need to check contracts.</p>	<p>See Article 23FA(2), (3), (4)(b) and (9)</p>
Impact on relevant fallbacks	
<p>5. The Act does not apply if a contract or arrangement provides expressly that it should not.</p>	<p>See Article 23FB – and especially Article 23FB(5)</p>
<p>6. Does not prevent or otherwise affect the operation of a fallback provision – but note important limits. In particular, the Act provides that benchmark cessation triggers are not activated by Article 23A designation and modification.</p>	
<p>7. Careful consideration of contracts and fallbacks will be needed. Broadly speaking, though:</p> <ul style="list-style-type: none"> • for bonds: <ul style="list-style-type: none"> ○ Type 1 fallback trigger (<i>the "old style" triggers and fallbacks - generally pre-dating the July 2017 announcement of LIBOR cessation</i>): should move to synthetic LIBOR without triggers being activated; ○ Type 2 fallback trigger (<i>i.e., generally post-2017 and which contemplate LIBOR cessation</i>): UK FCA designation and modification will not constitute "cessation" of a benchmark and will therefore not activate "cessation" fallback triggers; and ○ Type 3 fallback trigger (<i>i.e., "no longer representative" trigger</i>): should operate as intended by the parties and fallback in way provided for in terms and conditions. • for loans and certain other LIBOR-referencing agreements: <ul style="list-style-type: none"> ○ Type 1 fallback trigger (<i>i.e., the "Screen Rate" being "unavailable" - generally seen in LMA-style loan documentation which has not been amended to include fallback or "rate switch" provisions in contemplation of LIBOR cessation</i>) – should move to synthetic LIBOR for the relevant tenor without the trigger being activated as LIBOR will continue to be available for the tenors which will be published on a synthetic basis. For those tenors which are not published on a synthetic basis and will cease, fallback triggers may be activated and fallbacks, such as interpolation between tenors of LIBOR, may apply. A LIBOR-referencing agreement which contains no fallback triggers would be treated in the same way as one with Type 1 fallback triggers. ○ Type 2 fallback trigger (<i>i.e. triggers similar to the "rate switch trigger events" generally seen in LMA-style loan documentation which provide a switch away from the use of LIBOR on the occurrence of such an event</i>) – should operate as intended and facilitate transition away from the use of LIBOR to an alternative rate. Although the documentation is likely to include a backstop date for transition in any event, the permanent cessation of certain LIBOR tenors would, unless the contract parties have agreed otherwise, trigger the rate switch for the relevant currency (and any pre-cessation trigger may also be activated). 	

- **"Replacement of Screen Rate"** type language does not provide for fallback or rate switch provisions (as it is a mechanic to facilitate an amendment process with a lower consent threshold than may otherwise be required) and so would not be affected. Documentation which only includes this language to address LIBOR cessation, would likely include a Type 1 fallback trigger.

Litigation risk and safe harbours

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| 8. Does not contain a general safe harbour (unlike the NY legislation). However, in the parliamentary debate, the UK Government representative stated that, in the Government's view, the contract continuity provisions summarised above " <i>will comprehensively address the risk that parties might successfully dispute the use of synthetic LIBOR to calculate payments after the end of the year</i> ". | <i>See Article 23FA(1) - (5)</i> |
| Does, however, grant immunity for the benchmark administrator from claims for damages when acting pursuant to the UK FCA's direction. | <i>See Article 23FC (Liability of administrator of Article 23A benchmark)</i> |
| 9. Does not extinguish or affect causes of action pre-existing before Article 23A designation. | |
| 10. Does not create any right, obligation or liability in relation to an act or omission relevant to the formation or variation of the contract or arrangement, where the formation or variation took place before Article 23A designation or operation of the contract or arrangement before Article 23A designation. | <i>See Article 23FA(7);
See Article 23FA(6)</i> |

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