19th March 2021

Ms Verena Ross,
Executive Director
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Via email: Verena.Ross@esma.europa.eu

Dear Ms. Ross,

RE: Joint letter on LIBOR transition

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

The European Financial Markets Lawyers Group (the "EFMLG") is a group of senior legal experts from the EU banking sector dedicated to making analysis and undertaking initiatives intended to foster the harmonisation of laws and market practices and facilitate the integration of financial markets in Europe. The members of the Group are selected on the basis of their personal experience amongst lawyers of major credit institutions based in the EU active in the European financial markets. The Group is hosted by the European Central Bank.

Since the announcement by the Financial Conduct Authority ("**FCA**") in 2017 that it would not guarantee the survival of LIBOR after the end of 2021, the transition from LIBOR to SONIA, SOFR and other chosen risk-free rates has occupied the derivatives, securities and loan markets. Authorities around the world have grappled with possible methods by which they may help the market to transition away from LIBOR, especially in relation to those legacy contracts which may not contain a fallback clause or be easily amended. Over the past year, authorities in the U.K., E.U. and U.S. have all proposed legislation to resolve the problem of legacy contracts, proposing statutory provisions that would certainly contribute to the transition away from LIBOR. The FMLC and EFMLG (the "**Organisations**") would like to take this opportunity to recognise the effort and commitment of the relevant authorities in avoiding negative consequences, manifested in the hard and complex work that has been undertaken to date.

In this regard, although the Organisations are of the view that regulatory efforts should be focused in finalising the ongoing legislative proposals, it might be helpful to consider

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the problem of potential conflict and overlap that may arise owing to the differences in the legislative approaches.[1] For example:

- "LIBOR" could be theoretically extant under English law as a screen rate but "in cessation" as a methodology and/or as a measure of London interbank unsecured lending rates and therefore replaceable by the statutory replacement rate ("**SRR**") under the proposed E.U. regime. In the case of cross-border contracts, the question of what the terms of the contract mean should be decided according to governing law of the contract, which entails that the SRR will not be automatically incorporated into a contract with an E.U. entity where that contract is governed by English law and that may cause a surprising and possibly chaotic result as far as the entity itself is concerned. Contracts involving E.U. entities with overseas elements could, in theory, be subject to competing interpretations as to which floating price can be strongly supported. In respect of legacy contracts, the prospect of contracts moving to different rates across currencies, products and instruments theoretically introduces a risk of disrupting cash flows and global hedges.

- A major concern is the potential disparity of fallback rates (or synthetic methodologies) which may be identified in different jurisdictions. Whilst it seems that some legislators may identify rates based on backward looking methodologies applied over risk free rates, others might be thinking of applying forward looking methodologies and even within such methodologies themselves, differing solutions may be adopted depending on the relevant product. The lack of consensus in this regard among the different legislators could cause serious market disruption and, therefore, should be avoided.

- The new powers that will be granted under the U.K. legislative initiative allow the FCA to direct a change in LIBOR methodology. Whilst this solution is positive per se, there is however a contingent risk that it could also provide a platform for litigation or result in the frustration of contracts in agreements that are subject to U.S. or E.U. law[2] unless there is some form of equivalence mechanism or other similar process to endorse legislative solutions implemented by U.K. authorities. In addition, both Organisations consider that the existence of legal safe harbour provisions to protect against litigation (as in the U.S. proposal) would help to overcome such risks.

- There is also a risk that similar situations might be treated differently under the various legislative systems. For instance, a fallback that fixes at the last publication of, or is based on, the benchmark would be overridden by the U.S. statutory fallback proposal, but pursuant to the European proposal it might be considered as a permanent fallback and thus the SRR would only apply to contracts containing such fallback if certain additional conditions are met. Similarly, LIBOR cessation without prior announcement of its lack of representativeness would trigger the SRR under E.U. and U.S. approaches, but

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[1] In the U.K., new powers will be granted to the FCA to help it manage an orderly "wind-down of critical benchmarks" by permitting the publication of a "Synthetic LIBOR". In the E.U., the European Commission published a proposal for a regulation to amend the Benchmarks Regulation giving the European Commission the power to designate a statutory successor for a benchmark whose cessation would result in significant disruption in the functioning of financial markets. In the U.S., the Alternative Reference Rates Committee ("**ARRC**") has proposed a different approach which has recently become a NY State Senate Bill: its legislative proposal will incorporate a successor rate by operation of law into contracts, where they are governed by local law.

[2] This risk would be higher if under the U.K. legislative solution, it is implicit that a change in the methodology implies that LIBOR is no longer representative of the underlying interest.

according to the initial proposal for the U.K. solution, the cessation scenario is not covered and only the lack of representativeness of LIBOR would allow the FCA to direct a change in the methodology.

In these circumstances, coordination by authorities in key jurisdictions around the discontinuance of LIBOR and the exercise of any powers to adapt the benchmark methodology and/or the terms of financial transactions is essential to avoid significant market confusion. The Organisations are aware of the letter sent by the Global Financial Markets Association recommending the establishment of a "tough legacy" cross-border collaboration working group to help facilitate policy alignment wherever possible of regulatory and legislative solutions.[3] Members of both Organisations would like to express support for the establishment of such an international initiative.

To that end, the Secretariats of the EFMLG and the FMLC stand ready to assist with such an exercise in cross-border coordination, whether by way of coordinating the exercise[4] or by providing analysis of substantive issues to members of such a working group.

Members of the EFMLG and the FMLC would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

[signed]

Joanna Perkins
FMLC Chief Executive

[signed]

Otto Heinz
EFMLG Chairman

[3] GFMA, *Letter: RE: Reforming Major Interest Rate Benchmarks: Cross-Border Issues in Transition*, (24 November 2020)

[4] FMLC CEO, Joanna Perkins, has participated in the Financial Stability Board's efforts on reforming interest rate benchmarks by managing the Market Participants Group's legal impact work on U.K. contracts.