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ISDA and Other Industry Groups Publish LIBOR “2018 Transition Roadmap”

On February 1, 2018, the International Swaps and Derivatives Association (ISDA), along with a number of other industry groups,[1] published the “2018 Transition Roadmap,” which is intended to be a central repository of information related to the phase-out of the world’s most prevalent financial benchmark (the London Interbank Offered Rate, or LIBOR). Although the “Roadmap” title would suggest that the document is setting forth a plan of action for the next steps in the LIBOR phase-out, the document is instead more of a “lookback” that serves as a single point of reference for already-public information.

The publication of the Roadmap comes about six months after the UK Financial Conduct Authority’s (FCA) announcement that, after the end of 2021, panel banks would no longer be compelled to submit pricing information for LIBOR. Effectively, as a result of this announcement, trillions of dollars of interest rate derivatives, loans, commercial and retail mortgages, securitizations, and other financial products that reference LIBOR will need to be amended, creating a massive transition burden on countless impacted market participants. Because there is no central entity “running” this transition, numerous industry initiatives and public-private partnerships have formed in order to determine the new risk-free reference rates (RFRs) that will replace LIBOR, and to help market participants understand what the transition away from LIBOR means for their contractual relationships. Unless you are following the LIBOR phase-out closely, keeping track of the organizations, new RFRs, timelines and transition plans is a job in and of itself.

And so, while it may not contain any new information, the Roadmap is a valuable tool for market participants to understand (i) why LIBOR is going away, (ii) what the known challenges are to transitioning away from LIBOR, (iii) who the key players are in the LIBOR phase-out, (iv) which initiatives are underway, (v) what the chosen alternative rates are for each of the LIBOR denominations, and (vi) next steps in the

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LIBOR phase-out process. A summary of the key elements of the Roadmap follows.

<u>Scope and Objectives</u>

The Roadmap has three main objectives:

1. To centralize information that is already publicly available by financial regulators and industry working groups;

2. To facilitate market education about transitioning financial contracts away from LIBOR to alternative RFRs; and

3. To serve as a baseline of information that will be used in the survey and report that the Trade Associations expect to issue in the coming months (discussed further below).

The scope of the Roadmap includes various LIBOR denominations, including U.S. dollar LIBOR, UK pound LIBOR, EURIBOR, Swiss Franc LIBOR, and Japanese Yen LIBOR, among others. The Roadmap covers a variety of financial products, including but not limited to derivatives (over-the-counter and exchange-traded), loans (including mortgages, credit cards and student loans), bonds and floating rate notes, short-term instruments (including repos and commercial paper), and securitized products (including mortgage-backed securities and collateralized loan obligations). Nearly every financial market participant imaginable is included in the scope of the Roadmap, from exchanges and clearinghouses to banks and hedge funds to government-sponsored enterprises to asset managers. Notably, retail borrowers appear to be left out of the Roadmap, although they are arguably encompassed by the "Others" category of market participants.

<u>LIBOR Background</u>

In this section of the Roadmap, the Trade Associations identify the different denominations and tenors of LIBOR, along with the wide range of product types in which the benchmarks are used. Of note, U.S. Dollar LIBOR and EURIBOR are the most prevalent rates, making up 80% of all LIBOR market exposure (more than $370 trillion). Derivatives, both over-the-counter and exchange-traded, make up more than 80% of all financial products that reference LIBOR. 97% of U.S. syndicated loans reference U.S. Dollar LIBOR ($3.4 trillion of exposure) and 90% of EU syndicated loans reference EURIBOR ($535 billion of exposure).

<u>LIBOR Reform</u>

U.S. and non-U.S. financial regulators began exploring LIBOR reform as early as 2009, after it came to light during the "LIBOR Scandal" that multiple panel banks, which were contributing pricing information for the calculation of LIBOR, were providing fraudulent submissions and manipulating the rates in their favor. Subsequently, new organizations were founded in order to oversee and implement benchmark reform, the G20 tasked the Financial Stability Board with reviewing and reforming the major benchmarks, and the International Organization of Securities Commissions (IOSCO) published a report in which it identified 19 principles for sound benchmarks. These efforts and others culminated in the UK FCA's July 2017 announcement that "the survival of LIBOR… could not and would not be guaranteed" (leading us to present day).

To date, the industry and financial regulators have focused on the following four areas:

1. Enhancing major interbank interest rate benchmarks by improving transaction data and price submission processes;

2. Developing new or existing alternative RFRs to replace LIBOR in a variety of financial contracts;

3. Developing transition strategies to adopt the alternative RFRs; and

4. Increasing contractual robustness (i.e., mitigating the risks associated with permanently discontinuing a popular denomination of LIBOR).

Obviously, the hopes for benchmark enhancement in #1 have dissipated (as opposed to the benchmark replacement efforts in #2-4, which have gained speed).

Benchmark Transitions and Challenges

The Trade Associations identify a number of potential challenges in the Roadmap associated with the LIBOR phase-out. Most notably, market participants across multiple sectors will need to be educated in order for the alternative RFRs to be adopted, and significant resources will need to be devoted to these education efforts. The markets underlying the alternative RFRs will need to have sufficient liquidity. There may be tax, accounting, and margining implications that result from shifting to the new RFRs.

Most importantly, particularly for the readers of this Client Alert, it will be a massive undertaking in order to transition contracts away from LIBOR and to incorporate the new RFRs. Contract amendments will increase costs for market participants, and transitioning legacy contracts has the potential to create basis risk, less effective hedges, and/or market valuation issues. It will be vital to seek legal counsel during this transition process, in order to properly prepare for and minimize the fallout from the LIBOR phase-out.

Next Steps

Public-private RFR working groups, such as the Alternative Reference Rate Committee (ARRC) based in the United States, are in the process of crafting solutions to the LIBOR transition challenges, and are working to expand their membership to include a more diverse mix of market participants. The Trade Associations plan to launch a global survey in the coming months, gathering information from buy-side and sell-side firms, as well as infrastructure providers, on how they use LIBOR, how ready they are to transition away from LIBOR across their product lines, what problems they foresee and what solutions they propose. Many if not all of these solution-oriented processes will create opportunities for entities impacted by the LIBOR phase-out to engage and provide input into the transition. The end-goal, according to the Trade Associations, is for financial markets to lessen their reliance on LIBOR with minimal market disruption.

In sum, the Roadmap is an excellent resource for market participants seeking to get up to speed on the LIBOR phase-out. The Roadmap does not provide any new information, or set forth a plan of action for the transition (despite its name), but it does contain easily-digestible details about the need for benchmark reform, the various LIBOR transition initiatives, and the potential challenges ahead.

Questions on how the transition away from LIBOR will impact your derivatives contracts or lending documentation? Want to learn more about how to proactively prepare for the LIBOR phase-out? Please contact Alec Fraser, Cheryl Aaron, or the Michael Best attorney with whom you regularly work for more information.

[1] Along with ISDA, the Roadmap was published by the Association for Financial Markets in Europe (AFME), the International Capital Market Association (ICMA), and the Securities Industry and Financial Markets Association (SIFMA) and its asset management group (SIFMA AMG) (collectively, the " Trade Associations").

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