

Banking & Finance Alert

LIBOR is changing - How will it affect financial contracts?

The UK Government's independent Wheatley Review of LIBOR published its Final Report on 28 September 2012 recommending comprehensive reform, but not replacement, of LIBOR. In this briefing, we provide a high level overview of the proposed changes and offer some initial thoughts on how the proposed changes might affect typical loans (primary and secondary), CLOs, derivatives, bonds, structured products and repo transactions.

Executive summary

- Wheatley Review recommends regulatory, governance and technical changes to LIBOR.
- Material disruption of contracts likely to be avoided, but...
- Review your LIBOR definitions and fallback provisions as well as risk disclosure.

potential template for the ongoing global and domestic reviews of benchmarks.

What is LIBOR?

LIBOR (the London Inter-Bank Offered Rate) is intended to reflect the average rate at which banks can obtain unsecured funding in the London money market for a given period and a given currency. See Box 1 for the quoted currencies and maturities.

LIBOR: what's going on?

LIBOR and other benchmarks have been the subject of ongoing global regulatory investigations since 2009. However, from June to September 2012, there has been a blaze of publicity focused on LIBOR and also a number of major developments. These developments have included the first enforcement action against a bank in the UK and US, and a raft of UK, EU and international consultations, reports and proposed regulatory or legislative changes. See Annex 1 below for a brief chronology of recent events.

The "[Wheatley Review of LIBOR: final report](#)" published on 28 September 2012 (the "Wheatley Report"), discussed below, is just one of these initiatives but of fundamental importance as its conclusions will not just shape the development of LIBOR but will also be likely to influence the approach taken in the UK and globally to other important benchmarks. International regulators have already welcomed the Wheatley Report as a

Box 1

LIBOR is currently quoted and published for 10 currencies (American dollar, Australian dollar, British pound sterling, Canadian dollar, Danish krone, euro, Japanese yen, New Zealand dollar, Swedish krona and Swiss franc) and 15 maturities per currency (overnight, 1 week, 2 weeks, 1 month, 2 months, 3 months, 4 months, 5 months, 6 months, etc. to 12 months) making 150 fixings in total.

It is calculated in London using submissions from a panel of between 6 and 18 contributing international banks, with different panels for each currency, in each case answering the official LIBOR question set out in Box 2 below. The calculation process uses a "trimmed arithmetic mean" discarding the highest and lowest submissions and averaging the remaining submissions to create LIBOR for a given day. The rates are published daily by Thomson Reuters on behalf of the British Bankers' Association ("BBA") which is the official administrator of the LIBOR process.

Box 2

What *actually* is LIBOR? LIBOR is officially the answer to the following question which panel banks are required to answer for each given currency and tenor: *"At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11am?"*

Over the three decades since its inception in the 1980s, LIBOR has transitioned from being a London money market rate to a global financial benchmark used to determine payments under OTC and exchange-traded derivatives, bilateral and syndicated loans, variable rate mortgages and floating rate notes with an aggregate estimated notional amount of anywhere between US\$300-800 trillion.

Difficulties with LIBOR

The main issues with LIBOR have been identified as follows:

- the LIBOR definition is broad and subjective and submissions are based on estimates of borrowing costs rather than on actual transactions, and therefore submissions require judgements and exercise of discretion;
- LIBOR became "dysfunctional" in the financial crisis in the absence of reliable consistent actual trades as actual inter-bank lending dried up due to concerns over the creditworthiness of other banks and their exposure to "toxic" assets;
- LIBOR has become perceived as an indicator of a bank's financial health, creating a vicious circle as the perception of financial difficulty itself raises a bank's borrowing costs;
- the inter-bank market has become less relevant with a significant decline in this form of funding relative to others such as secured borrowing, retail deposits and accessing central bank liquidity. This in turn has led to there being less information to inform banks' judgements in their submissions and less information available to corroborate those submissions;
- the system is largely self-policing and vulnerable to abuse; and
- there is no clear regulatory framework for regulating LIBOR, and the existing sanctions regime is considered insufficient.

Wheatley Review and key recommendations for change

The UK Government commissioned an independent review of LIBOR on 2 July 2012 to be led by Martin Wheatley, managing director of the Financial Services Authority ("FSA") and CEO-designate of the forthcoming new Financial Conduct Authority ("FCA"). It issued its final report on 28 September 2012 in under three months and including a four week consultation period. See Box 3 for a summary of the proposed changes.

Box 3

Proposed changes at a glance:

- LIBOR submissions and administration to be expressly regulated, including key individuals, and civil and criminal sanctions to be clarified
- BBA to be replaced as LIBOR administrator – independent tender process to appoint new administrator
- Number of currencies and tenors to be dramatically reduced
- Banks' submissions to be informed and corroborated by actual transaction data, drawn from a wider range of funding transactions
- New code of conduct governing submissions
- Publication of individual submissions to be delayed by 3 months
- Banks to be encouraged to participate in LIBOR panels, potentially by regulatory compulsion if necessary
- Market participants encouraged to re-evaluate use of LIBOR and adequacy of contractual fallback provisions in the context of failure of LIBOR
- International coordination of debate on future of LIBOR and other global benchmarks and to establish global standards.

The fundamental underlying assumption for the recommendations of the Wheatley Report is that whilst the current system is broken, LIBOR is not "beyond repair". A recognition of the deep entrenchment of LIBOR in the financial markets, the difficulty of identifying or creating (in the short term at least) an obviously superior alternative benchmark and the risk of significant disruption to the financial markets, outstanding transactions and contracts militated against replacement and in favour instead of comprehensive reform.

The key changes proposed by the Wheatley Report can be grouped under four headings: governance/institutional reform; technical changes to LIBOR; regulation; and contingency planning.

Governance/institutional reform: Perhaps the most significant change here – and one with potential impact on existing finance documentation – is that the BBA should transfer responsibility for LIBOR to a new administrator. That new administrator would, as part of its governance and oversight of the rate, be required to fulfil specific obligations as to transparency and fair and non-discriminatory access to the benchmark. It would also, as a priority, introduce a code of conduct for submitters.

Technical changes to LIBOR:

One recommendation which could also have an impact on financial documentation is that the BBA should cease publication of LIBOR for those currencies and tenors for which there is insufficient trading (and therefore insufficient transaction data) to corroborate LIBOR submissions. Specifically, it is recommended that publication of the rates for Australian dollar, Canadian dollar, Danish krone, New Zealand dollar and Swedish krona should be discontinued, and that for the remaining currencies, the 4, 5, 7, 8, 10 and 11 month tenors should no longer be published (with a suggestion that all other tenors should also be reconsidered with the exception of 1 month, 3 month, 6 month and 12 month LIBOR). This would very significantly reduce the number of LIBOR rates published from the current 150 to 20. These rates would be phased out in a 12-month period, or potentially earlier, in consultation between the BBA and the market.

To overcome what is perceived a "free rider" problem, a much broader range of banks should be encouraged (if necessary by regulatory compulsion) to engage in the LIBOR submitting process.

The BBA should delay the publication of individual LIBOR submissions for 3 months as a means both to break any link between submissions and signals of creditworthiness, and to reduce the scope for attempted manipulation.

Banks should immediately start using available transaction data to inform and corroborate their LIBOR submissions, drawing that data from a broader range of money market and other transactions.

Regulation: The administration of LIBOR and the making of LIBOR submissions should be made "regulated activities" under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and manipulation or attempted manipulation of LIBOR should become an offence under Section 397 of the Financial Services and Markets Act 2000.

Contingency planning: Market participants should consider whether to move to alternative benchmarks for any particular types of transactions currently referencing LIBOR and whether existing LIBOR definitions in their contracts contain adequate contingency provisions covering the event of LIBOR not being produced or being replaced.

Looking beyond the UK, it is recommended that the UK authorities should work closely with the European and international community to establish clear and (to the extent possible) universal principles for effective global benchmarks.

Next steps

Note that the Wheatley Report recommendations are divided into some which are for the BBA, banks and market participants and which can therefore begin to be implemented immediately, and some which are for the UK Government which will require legislative implementation. The next phase for the latter in this fast-moving regulatory initiative is the formal response of the UK Government and subsequently an implementation of any accepted recommendations in the Financial Services Bill which is currently before the House of Lords. However, the release of the Wheatley Report was accompanied by a firm commitment from the Financial Secretary to the Treasury, Greg Clark, as to the need for immediate action to restore the damage to the reputation of the banking and financial industry, and Mr Clark indicated that the formal response of the UK Government will be provided in the first week following the return of Parliament (scheduled for 15 October 2012).

The FSA will expect firms to take appropriate steps to prepare for the impact of these proposals. A failure to do so would be likely to be considered a breach of the FSA's governance requirements set out in its systems and controls handbook (SYSC) and of General Principle 3, that firms must organise their affairs properly with appropriate systems and controls.

Effect on financial contracts

The Wheatley Report clearly recognises the potential effect of any radical changes to LIBOR on existing financial contracts and sought to avoid any material disruption. It is to be anticipated that the proposed reforms would be largely successful in avoiding any such material disruption.

However, it is likely that some of the proposed changes will have an effect on some outstanding agreements and transactions referencing LIBOR or other benchmarks. There is a clear difference between "official LIBOR" (being the actual basis on which LIBOR is officially quoted and calculated – see Box 2 above for the official question) and "contractual LIBOR" (being the contractual definition of LIBOR in any particular financial contract). There are multiple contractual definitions of LIBOR in use (including under legacy transactions which may have been entered into many years ago), some of which will be standardised definitions and some of which will be bespoke. Even standardised definitions will have had multiple iterations over the years, and will be different between markets.

In addition, the Wheatley Report itself recommends that market participants consider the contingency provisions of existing LIBOR definitions, not just for current weaknesses in the fallbacks but also, one suspects, to make it easier for participants in the different markets to migrate away from LIBOR for certain purposes in the future.

Box 4

Key areas of contractual focus for financial markets participants following the publication of the Wheatley Report are therefore likely to include the following:

- **contractual due diligence** to establish the range of LIBOR definitions and benchmarks in their transactions;
- **contractual due diligence or review of operational records** to identify which (if any) transactions contain LIBOR currencies or maturities which are to be discontinued;
- **contingency planning**, in conjunction with any relevant market associations, in relation to proposed and potential future changes to LIBOR and other benchmarks, and the effect these changes or other longer-term disruption or discontinuance of LIBOR or such benchmarks may have on existing definitions and contracts, including in particular the

issues described below;

- the **effect (if any) on contracts** of the **transfer of the BBA's role** as LIBOR administrator to a new administrator or administrators;
- the effect (if any) on contracts of the **discontinuance** of compilation and publication of **certain LIBOR currencies and tenors**;
- a review of LIBOR definitions to evaluate the adequacy of the relevant **fallback provisions** to cover planned and potential changes to LIBOR, and the possibility of LIBOR not being produced;
- whether **risk factors and disclosures** should be included in termsheets and contracts to cover LIBOR/benchmark-related issues; and
- the effect (if any) of the proposed changes on **proprietary indices**.

We set out in Annexes 2 to 7 some initial thoughts on LIBOR/benchmark issues in some of the more common financial transactions. These are, of course, very preliminary and intended to provide a high level overview of relevant considerations. All will depend on parties' actual documentation for any transactions and the specific changes to LIBOR and other benchmarks that are implemented. Market associations will also be working with financial market participants to seek to develop market-wide solutions where possible.

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Annex 1: Chronology of recent events

Since 2009:

- FSA and various regulators and public authorities globally (including the EU, US, Canada, Japan and Switzerland) have been investigating alleged misconduct relating to LIBOR, EURIBOR and other benchmarks
-

27 June 2012:

- FSA fines Barclays for misconduct relating to LIBOR and EURIBOR
 - US CFTC and US DoJ also impose penalties
-

2 July 2012:

- UK Government commissions independent review (the "Wheatley Review") of the framework for setting and governing LIBOR, and sanctions for abuse (to report by end of September 2012)
-

6 July 2012:

- SFO launches criminal investigation into manipulation of LIBOR and other rates
-

25 July 2012:

- European Commission proposes amendment to EU law to prohibit and criminalise manipulation of LIBOR and other benchmarks (MADII)
-

10 August 2012:

- UK Government announces initial thinking on Wheatley Review:
 - retaining LIBOR unchanged is not a viable option
 - discussion of possible options
-

18-20 August 2012:

- UK Government Treasury Select Committee inquiry publishes report: "Fixing LIBOR: some preliminary findings"
-

20 August 2012:

- European Parliament's Economic and Monetary Affairs Committee (ECON) launches public consultation on reform of LIBOR and EURIBOR
 - Responses published 20 September 2012
-

5 September 2012:

- European Commission "Consultation Document on the Regulation of Indices"
-

10 September 2012:

- BIS central banks establish body to examine issues with LIBOR and other reference rates and take forward
-

24 September 2012:

- ECON public hearing on LIBOR – bankers and regulators to attend and answer questions
-

28 September 2012:

- The Wheatley Report published
-

Forthcoming:

- UK Government response to Wheatley Report recommendations (towards end of October 2012)
-

Ongoing:

- Global investigations – competition, regulatory, legislative, criminal
-

Annex 2: Loans – LMA documentation

Shortly after the publication of the Wheatley Report, the Loan Markets Association ("LMA") announced that it will be reviewing the report and any potential impact on LMA documentation in detail and that it will consult with the market as to the appropriate action to take.

PART A: PRIMARY LOAN DOCUMENTATION

LIBOR definition: LMA Multicurrency Term Facility Agreement

"LIBOR" means, in relation to any Loan:

- a) the applicable Screen Rate; or
- b) (if no Screen Rate is available for the currency or Interest Period of that Loan) the Reference Bank Rate, as of the Specified Time on the Quotation Day for the currency of that Loan and for a period comparable to the Interest Period of that Loan.

"Screen Rate" means:

- a) in relation to LIBOR, the British Bankers Association Interest Settlement Rate for the relevant currency and period [...] displayed on the appropriate page of the Reuters screen. If the agreed page is replaced or service ceases to be available, the Agent may specify another page or service displaying the appropriate rate after consultation with the Company and the Lenders.

"Reference Bank Rate" means the arithmetic mean of the rates (rounded upwards to four decimal places) as supplied to the Agent at its request by the Reference Banks:

- a) in relation to LIBOR, as the rate at which the relevant Reference Bank could borrow funds in the London interbank market [...]

in the relevant currency and for the relevant period, were it to do so by asking for and then accepting interbank offers for deposits in reasonable market size in that currency and for that period.

Transfer of responsibility from the BBA to a new administrator

The key definition is the Screen Rate definition (see Box opposite). The definition specifically refers to the "British Bankers Association Interest Settlement Rate". Neither the Screen Rate definition itself, nor the construction provisions contained in the LMA documentation, clearly deal with a successor entity

to the BBA being appointed. However, there is flexibility within the Screen Rate definition for the page on which LIBOR is displayed to be replaced with another page, or for a different service to be used. At this stage, without knowing exactly how the transition from the BBA to a new administrator entity will be achieved, and whether existing terminology will remain the same, it is not possible to say with certainty whether the LMA Screen Rate definition will work as currently drafted. That said, the continuing message throughout the Wheatley Report is that all parties are keen for the recommendations to be implemented with minimal disruption to existing contractual arrangements.

Reduction in the publication of LIBOR for certain currencies and tenors

This is not likely to have a significant impact on loan documentation:

- most of the interest periods in loan agreements which are pre-agreed in documentation are the more liquid rates referred to in the Wheatley Report. If a non-standard interest period is required, the standard LMA documentation already provides for this to be agreed separately between the lenders and the borrower; and
- where non-standard currencies (for example, Swedish krona, which is used as an example in the Wheatley Report) are pre-agreed currencies, additional definitions which reference the local benchmarks (for example, STIBOR) are usually incorporated in addition to the standard LIBOR definition. Generally speaking, the pre-agreed currencies tend to be "standard" currencies, for which it would appear from the Wheatley Report that a LIBOR rate will continue to be published. However, where loan agreements do refer to currencies or tenors which are discontinued, it may be necessary to consult the relevant fallbacks (see "LIBOR fallbacks" below).

LIBOR fallbacks

It is clear from the Wheatley Report that it is thought that LIBOR is still an appropriate rate for use in floating rate loan agreements. However, in relation to the adequacy of contingency provisions covering the event of LIBOR not being produced, the Wheatley Report suggests that further review of standard provisions will be required. The LMA documentation uses a standard reference bank fallback formulation in the event that LIBOR is not

available. Two problems highlighted by the Wheatley Report with this approach are that:

- given the huge volumes of contracts which reference LIBOR, if LIBOR was not available, the sheer volume of existing contracts would overwhelm the reference banks, making this approach unworkable; and
- the reference banks who would be called upon to provide the alternative rates would generally be the same banks submitting LIBOR, with the result that there would be a risk that those banks would not be prepared to provide quotes in circumstances of LIBOR failure.

At present, under the LMA documentation, the parties would need to look to the Market Disruption provisions in the event that the reference banks are unable to provide a rate. If a Market Disruption Event occurs, the LMA provisions allow a Lender instead to charge its costs of funds on its share of the loan from whatever source it may reasonably select, or allow the Agent and the Company to enter into negotiations for a period of not more than 30 days with a view to agreeing a substitute basis for determining the rate of interest. The Wheatley Report discusses various alternative benchmarks which could be used for financial transactions instead of LIBOR, so it may be the case that in future parties modify the fallback mechanics to include not only a reference bank mechanism, but also specific reference to certain of these alternative benchmarks before having to rely on the Market Disruption provisions. However, many of the alternative benchmarks which have been suggested are overnight rates, which may therefore not be appropriate for use in the context of loan agreements which need to cater for longer interest periods.

PART B: SECONDARY LOAN DOCUMENTATION

LIBOR definition: LMA "Standard Terms and Conditions for par and distressed trade transactions (Bank debt/claims)"

"LIBOR" means for any day, the British Bankers Association Interest Settlement Rate for the offering of deposits in the relevant currency for a period of one month displayed on the appropriate page of the Reuters screen as of 11:00 a.m. (London time) on such day. If the appropriate page is replaced or service ceases to be available, the Seller, acting reasonably, may specify another page or service displaying the appropriate rate.

"Average LIBOR" means, for the Delay Period, the result of dividing (a) the sum of all the individual LIBORs for each day in the period from and including the date 2 Business Days before the Delay Period Commencement Date and to but excluding the date that is 2 Business Days before the Settlement Date by (b) the total number of days in such a period.

Transfer of responsibility from the BBA to a new administrator

In the standard terms and conditions, for par and distressed trade transactions (bank debt/claims) (the "**Standard Terms and Conditions**") LIBOR is used to calculate delayed settlement (discussed below, see "LIBOR fallbacks").

The definition of LIBOR in the Standard Terms and Conditions largely tracks that in the Primary documentation, specifically referring to the "British Bankers Association Interest Settlement Rate". Consequently, the analysis largely follows that in Part A above.

Reduction in the publication of LIBOR for certain currencies and tenors

This aspect of the Wheatley Report is not likely to have a significant impact on the standard documentation for secondary market debt trading. The overwhelming majority of contracts relate to the more liquid currencies and tenors that will continue to be published, including but not limited to, sterling, the euro and US dollar.

PART B: SECONDARY LOAN DOCUMENTATION (cont'd)

In any event the definition of "LIBOR" refers to the one month rate and it is not proposed that this tenor be discontinued. However there would be an element of contractual uncertainty in the event that a LIBOR rate for a particular currency is discontinued as this situation would not appear to be covered by the fallback wording within the definition of "LIBOR".

LIBOR fallbacks

The point noted in Part A above as to flexibility within the Screen Rate definition with respect to the Agent applies similarly with respect to the Seller in the definition of LIBOR used in the Standard Terms and Conditions.

The ability of the Seller, in certain circumstances, to specify "another page or service displaying the appropriate rate" provides a fallback in the event that the "appropriate page is replaced" or "service ceases to be available". The Seller would have to act "reasonably" in selecting an alternative "page" or "service"; allowing for a commercially acceptable position to be reached between the parties.

However, as noted above, the existing fallback does not appear to catch the scenario of a LIBOR rate in respect of the relevant currency ceasing to be available as this situation would not appear to be covered by the fallback wording within the definition of "LIBOR".

Beyond this, the LMA may, in light of the recommendations of the Wheatley Report, have to consider whether this definition of LIBOR contains sufficiently "robust contingency procedures" in the event that there is "longer term disruption to the publication of LIBOR". In this respect, the LMA may have to consider creating standard contingency alternatives to the use of "LIBOR" rather than relying on the existing clause's flexibility.

To do this, the LMA would have to consider the actual scenarios where LIBOR is being applied under the standard documentation for par and distressed trade transactions, one of which is delayed settlement (standard terms and conditions for par and distressed trade transactions, bank debt/claims, clause 10.2). This is where compensation is provided for the cost of carry involved in funding the continued retention of the debt, past the specified settlement dates (T+10 in the case of par and T+20 in the case of distressed). The calculation for delayed settlement is based on either Average EURIBOR or, where this is not applicable, "Average LIBOR".

However it is unclear what contingency arrangement the LMA might consider an appropriate substitute for LIBOR in this context. The Wheatley Report canvasses a number of possible arrangements, including, although not limited to, the use of overnight index swaps, secured lending and synthetic rates none of which appear directly equivalent; nor is it clear that these would provide a better proxy to LIBOR for the costs of carry in stressed conditions. One option the LMA may consider is to extend the remit of the LMA Pricing Panel to explicitly include the power to resolve a pricing dispute that has arisen from a "long term disruption to LIBOR", this could provide it with the required flexibility to respond to changing market conditions.

Other issues

The Wheatley Report also stated that a determination should be made as to whether LIBOR was the most appropriate reference rate for the purpose of the contract (Wheatley Report, para 6.17). The secondary loan market will perhaps need to consider whether the use of Average LIBOR (which we note is a one month rate) remains an appropriate rate or whether rather a market overnight rate such as SONIA, EONIA or Fed Funds would be more appropriate.

Annex 3: Loans – CLOs

The elements of a typical CLO transaction which could be affected by any changes to LIBOR include: underlying assets (such as loans and bonds); any relevant interest rate or cross-currency or perfect assets swaps; and any floating rate bonds issued. An issuer under a typical CLO (the "**CLO Issuer**") will be both long and short on LIBOR or similar benchmarks, particularly EURIBOR, and so has an interest in potential variations in these rates from both points of view.

Transfer of responsibility from the BBA to a new administrator

Insofar as the CLO Issuer holds loan assets on LMA documentation or floating rate notes on typical capital markets documentation, the same considerations apply as those for Primary Loan Documentation and Bonds – Floating Rate Notes as given at Annex 2 above and at Annex 5 below, respectively.

In the light of the uncertainties associated with the impact of the replacement of the BBA on the functioning of the Screen Rate definition as described in the Primary Loan Documentation section above (see Annex 2, part A – "Transfer of responsibility from the BBA to a new administrator"), one would expect that the CLO Issuer (or its collateral manager on its behalf) may be involved in at least some "consultations" with Agent banks preceding the adoption of the successor LIBOR rate.

The CLO Issuer may also hold loans that are not on LMA documentation or more bespoke bonds or other similar instruments, where the contractual consequences of changes to LIBOR may be less certain. The analysis of such instruments would need to be on a case-by-case basis.

Swaps entered into by the CLO Issuer will typically incorporate ISDA definitions and so the relevant considerations in respect of OTC derivatives as discussed in Annex 4 below will apply.

In relation to the indebtedness of the CLO Issuer, the position is likely to be somewhat simpler, since most CLO documentation will give the Calculation Agent some element of discretion to determine a successor screen rate for LIBOR.

Reduction in the publication of LIBOR for certain currencies and tenors

This proposal should not have a significant effect, as the overwhelming majority of loan and CLO floating rates are referenced to one of the more liquid LIBOR rates (i.e. 1, 3, 6 or 12 month).

For those loans and notes which are affected by the non-publication of LIBOR for certain currencies and tenors, it would be necessary to review the relevant terms of the affected loans/notes and it is to be expected that the CLO issuer would consult with Agent banks as to appropriate action.

LIBOR fallbacks

Here the market will face the same issues in defining LIBOR fallbacks as discussed in relation to loans in the Primary Loan Documentation section above.

In relation to the indebtedness of the CLO Issuer, there is commonly a provision to the effect that if the Calculation Agent cannot determine LIBOR, the Trustee will do so instead, with any necessary amendments to the conditions of the bonds. More generally, Trustees should have the discretion to concur in formal, minor or technical amendments to the conditions. However, we would expect Trustees to be conservative in exercising these discretions.

Annex 4: OTC derivatives (interest rate swaps) – ISDA documentation

LIBOR definition: 2006 ISDA Definitions (example: GBP-LIBOR-BBA)

"**GBP-LIBOR-BBA**" means that the rate for a Reset Date will be the rate for deposits in Sterling for a period of the Designated Maturity which appears on the Reuters Screen LIBOR01 Page as of 11:00a.m., London time, on that Reset Date. If such rate does not appear on the Reuters Screen LIBOR01 Page, the rate for that Reset Date will be determined as if the parties had specified "GBP-LIBOR-Reference Banks" as the applicable Floating Rate Option.

"**GBP-LIBOR-Reference Banks**" means that the rate for a Reset Date will be determined on the basis of the rates at which deposits in Sterling are offered by the Reference Banks at approximately 11:00a.m., London time, on that Reset Date to prime banks in the London interbank market for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount. The Calculation Agent will request the principal London office to each of the Reference Banks to provide a quotation of its rate. If at least two quotations are provided, the rate for that Reset Date will be the arithmetic mean of the quotations. If fewer than two quotations are provided as requested, the rate for that Reset Date will be the arithmetic mean of the rates quoted by major banks in London, selected by the Calculation Agent, at approximately 11:00a.m., London time, on that Reset Date for loans in Sterling to leading European banks for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount.

Transfer of responsibility from the BBA to a new administrator

It will be seen that, although the definition of "GBP-LIBOR-BBA" contains a reference to "BBA" in the defined term itself, the substantive definition is screen-based, referring to the relevant rate which appears on Reuters screen page LIBOR01 rather than referring to a rate administered by the BBA. Consequently, a change of administrator from BBA to a new administrator should not be problematic. However, it remains to be clarified whether the replacement of BBA would also lead to a change in the role of Thomson Reuters, in which event the

impact on this provision would need to be reconsidered.

Reduction in the publication of LIBOR for certain currencies and tenors

Currencies: certain of the currencies likely to be affected by this proposal do not have LIBOR options in the 2006 ISDA Definitions (New Zealand dollar, Swedish krona, Danish krone). For these, the discontinuance of such LIBOR publications would not be a concern.

For the others (Australian dollar, Canadian dollar), if there are outstanding transactions, the LIBOR rate fallback would need to be considered, which falls back to a Reference Banks test similar to that for GBP-LIBOR-BBA above. This would in theory raise the issues highlighted in the Wheatley Report, such as sufficient availability of transactions or excessive demand on the Reference Banks, which may lead to the need for contracts to be amended to agree the applicable rate to apply in these circumstances. However, in practice the issue may not be a significant concern as submissions to the Wheatley Review suggest that there are very limited outstanding transactions in these currencies.

Tenors: if an existing tenor is discontinued which is used in an outstanding transaction, the Reference Bank fallback in the GBP-LIBOR-BBA definition (for example) would apply as the LIBOR rate in the definition is tied to a specific tenor (Designated Maturity).

Interpolation: a further technical issue arises with discontinuance of certain tenors. If an existing transaction applies Linear Interpolation to a transaction for a future calculation period (for example, a final stub period), and in the interim one or more existing tenors of the relevant LIBOR rate are discontinued, then this will potentially affect the rate which will be applied to that period. For example, if the calculation period would have been 4.5 months, then Linear Interpolation would have applied a rate calculated by interpolating between the 4 month and 5 month LIBOR rates. If those tenors are discontinued as proposed, the rate would switch to being one determined by interpolation between the 3 month and 6 month LIBOR rates which could give a very different result.

LIBOR fallbacks

The scenario of discontinued currencies and tenors above demonstrates the limitation of the existing fallbacks to deal with material changes to LIBOR. The Reference Bank fallback itself has the disadvantages explained in the Wheatley Report in the scenario of LIBOR not being produced and it is likely that this issue will be considered by ISDA at a market association level.

Other issues

Broadening transaction types: although this LIBOR definition is screen-based, it also hardwires in certain detail, including that the relevant rate is one which reflects a "rate for deposits", as opposed to other sources of funding, or other transaction types.

However, the Wheatley Report's recommendation that banks use broader transaction types to inform and corroborate their LIBOR submissions is carefully constructed not to disturb this type of provision, as the rate quoted by banks will still be for deposits in the inter-bank market, but they may refer to other transaction types in determining what rate would apply in the inter-bank deposit market.

Hedging mismatch: even where there is no direct impact on OTC contracts such as interest rate swaps, where the primary obligations which they are intended to hedge (for example in a broader loan financing structure) are affected by the proposed reforms, then mismatches may arise. In addition, differently worded fallbacks in a derivative and the relevant underlying instrument could lead to mismatches.

Annex 5: Bonds – floating rate notes

LIBOR definitions

The majority of floating rate notes are issued under euro medium term note programmes. These typically provide for floating rates to be determined on the basis of ISDA Determination or Screen Rate Determination.

ISDA Determination: In the case of ISDA Determination, as this directly references the 2006 ISDA Definitions, the considerations set out above under OTC Derivatives will apply.

There are typically no further fallbacks in ISDA Determination (as it relies on the fallback mechanism contained in the 2006 ISDA Definitions – see "GBP-LIBOR-BBA" definition above under OTC Derivatives, for example).

Screen Rate Determination: In the case of Screen Rate Determination, the documentation usually provides for the rate to be that on the Relevant Screen Page (typically LIBOR01) as at 11.00 a.m. on the interest determination date. If the successor to the existing LIBOR continues to be published on Reuters page LIBOR01, then the existing documentation will continue to work (provided that the relevant currencies and maturities are still available).

If the rate cannot be determined from the Relevant Screen Page, then the usual fallback will typically require the calculation agent to request quotations from the Reference Banks as of 11.00 a.m. and to determine the arithmetic mean of such quotations.

However we note that the Wheatley Report specifically highlighted (at paragraph 5.32) the likely shortcomings of such fallbacks, in that any fallback providing for reference banks and/or an indicative quote would be likely to prove to be impracticable due to the anticipated volume of rate requests.

If the calculation agent cannot obtain such quotations, then typically the documentation will provide either for good faith determination on the part of the calculation agent or for the rate applicable to the preceding interest period to be used. In the former case, the calculation agent may be reluctant to make a determination. In the latter case, it may lead to the interest rate on a floating rate note effectively being fixed for future interest

periods if the rate is otherwise unable to be determined.

Reduction in the publication of LIBOR for certain currencies and tenors

Where ISDA Determination is selected, the considerations set out above under OTC Derivatives with respect to the discontinuation of certain currencies and tenors will also apply to bonds (see Annex 4, OTC Derivatives) and where Screen Rate Determination is selected, the fallback provisions as specified in relevant terms and conditions will apply. However, the majority of bonds reference the more liquid currencies and interest periods, which it is not proposed be discontinued.

Hedging mismatch

The same considerations set out above under OTC Derivatives with respect to hedging mismatch will apply to bonds (see Annex 4, OTC Derivatives – hedging mismatch).

In addition, as the calculation agent for the notes is often not the same entity as the calculation agent for any interest rate swap which the issuer might have entered into (and is acting in respect of different transaction documents), there is an increased risk of mismatch with an interest rate hedge.

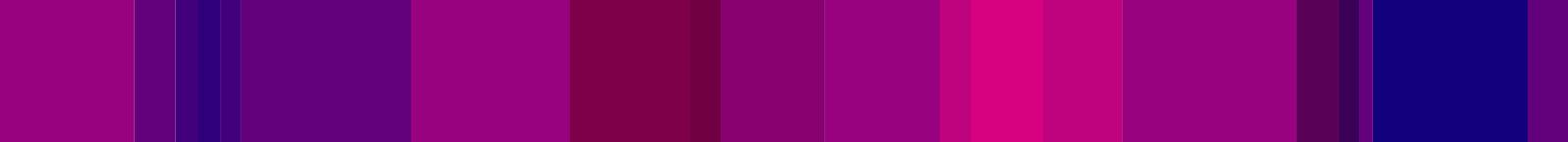
Interpolation

The considerations in respect of interpolation set out above under OTC Derivatives will also apply to any determination made in respect of a short or long interest period on the basis of linear interpolation (see Annex 4, OTC Derivatives – Interpolation).

Future transactions

We note that the Wheatley Report (at paragraph 5.12) specifically encourages issuers to take account of the various immediate and prospective changes to LIBOR in the annual update to their issuance programmes.

To account for potential disruptions to LIBOR or to any other benchmark rate, issuers may wish to build adjustment provisions into their conditions which would account for any modification, cancellation and/or disruption with respect to a



relevant rate. In addition to robust adjustment provisions, the ability of the calculation agent to determine the relevant rate in good faith and in a commercially reasonable manner should be included as the ultimate fallback. However, we note that calculation agents may be reluctant to make such determinations for fear of liability, notwithstanding the standard exculpatory language.

It would also be appropriate for those amendments to include a suitable risk factor in addressing these actual and potential changes.

Annex 6: Structured products

Existing transactions

The considerations set out above under Bonds – Floating Rate Notes (Annex 5) with respect to: LIBOR definitions; reduction in the publication of LIBOR for certain currencies and tenors; hedging mismatch; and interpolation will also apply to structured products.

In addition, there are specific issues applicable to proprietary indices, as set out below.

Future transactions

The considerations set out above under Bonds (Annex 5) with respect to Future Transactions will also apply to structured products.

Proprietary indices

While the Wheatley Report is focused on LIBOR and other widely used "benchmark" indices that pose systemic risks to the financial system, undoubtedly the regulatory developments following from the Wheatley Report will have an impact on increasingly popular "proprietary indices" used in many structured products. The Wheatley Report defines a "benchmark" as one which "relates to a standardised reference price, index or rate that can be used to ... determine financial flows arising from contractual agreements; price or value financial products; and assess the performance of assets and portfolios". This could potentially include proprietary indices. Further, the issues identified in the Wheatley Report with regard to benchmark indexes – for example, around lack of transparency and inherent conflicts of interest – apply equally (if not more so in certain cases) to private, proprietary indices.

The Wheatley Report also takes note that the European Commission is conducting a review of other benchmarks and has published a discussion paper on 5 September 2012 that covers many of the same issues, albeit with a wider remit of indices and benchmarks. As noted in ISDA's response to the review, the current definition of "benchmark index" in the EU Commission proposals would capture all proprietary indices.

Firms involved in creating proprietary indices may wish to take into account certain of the "features of a credible benchmark" set out in section 7.13 of the Wheatley Report, including that the index be:

- representative - the inputs should be a fair reflection of the underlying market;
- transparent – the methodology should be transparent and consistent, and should have clear rules;
- subject to credible oversight – there should be a credible governance structure.

Firms may wish to consider incorporating in the index methodologies adjustment provisions to deal with any modification, cancellation and/or disruption with respect to any relevant benchmark which is a constituent of a proprietary index and/or the proprietary index itself.

Annex 7: Repo agreements – GMRA documentation

LIBOR definitions

The proposed reforms to LIBOR may impact repo and structured repo trades to the extent that trades or agreements refer to LIBOR rates.

Pricing Rate: the definition of "Pricing Rate" in the 1995, 2000 and 2011 GMRAs does not specifically refer to LIBOR and leaves the counterparties to agree a per annum percentage rate for each transaction. It should initially be checked whether a LIBOR rate is incorporated into the relevant repo trade Confirmation and, if so, whether the proposed reforms affect such rate.

Where Confirmations use LIBOR rates incorporating by reference the 2006 ISDA Definitions (as many structured repo funding transactions do), similar issues will arise as for OTC Derivatives above, including in relation to any fallback rates which might apply (see Annex 4, OTC Derivatives).

Where a bespoke LIBOR definition is incorporated into a Confirmation, the terms of the specific contract would have to be reviewed to confirm the position.

Other: Both the 1995 GMRA and the 2000 GMRA contain provisions which refer to 1 month LIBOR rates as published on a designated Telerate Service page. No fallback mechanism is provided for the event that such rate is unavailable. The relevant provisions from the 1995 GMRA and 2000 GMRA which refer to LIBOR are Paragraph 12 (Interest), which relates to default interest, and Paragraph 10 in relation to interest on legal and professional expenses incurred by the non-Defaulting Party due to an Event of Default.

The lack of a fallback should be considered by market participants in conjunction with ICMA in order to make adequate provision for potential changes or discontinuance of LIBOR (note that one aspect which is not a concern is the proposed discontinuance of certain tenors as the proposal does not extend to 1 month LIBOR).

It could also be considered whether the use of LIBOR here is an example of a use of LIBOR as a benchmark which may not be strictly necessary. Given that the relevant provision relates to default interest and interest on costs and expenses, other benchmarks may be available and potentially more suitable such as an overnight rate – for example SONIA or other currency equivalent. Note that the 2011 GMRA removed all reference to LIBOR in these provisions in favour of an "Applicable Rate", meaning a rate selected by the non-Defaulting Party acting in a commercially reasonable manner or a rate agreed between the parties in a commercially reasonable manner. Potential amendments to the 1995 GMRA and 2000 GMRA default interest and expenses provisions might therefore be drafted in line with the existing position under the GMRA 2011.



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