

P.R.I.M.E. Finance New York Conference 2018  
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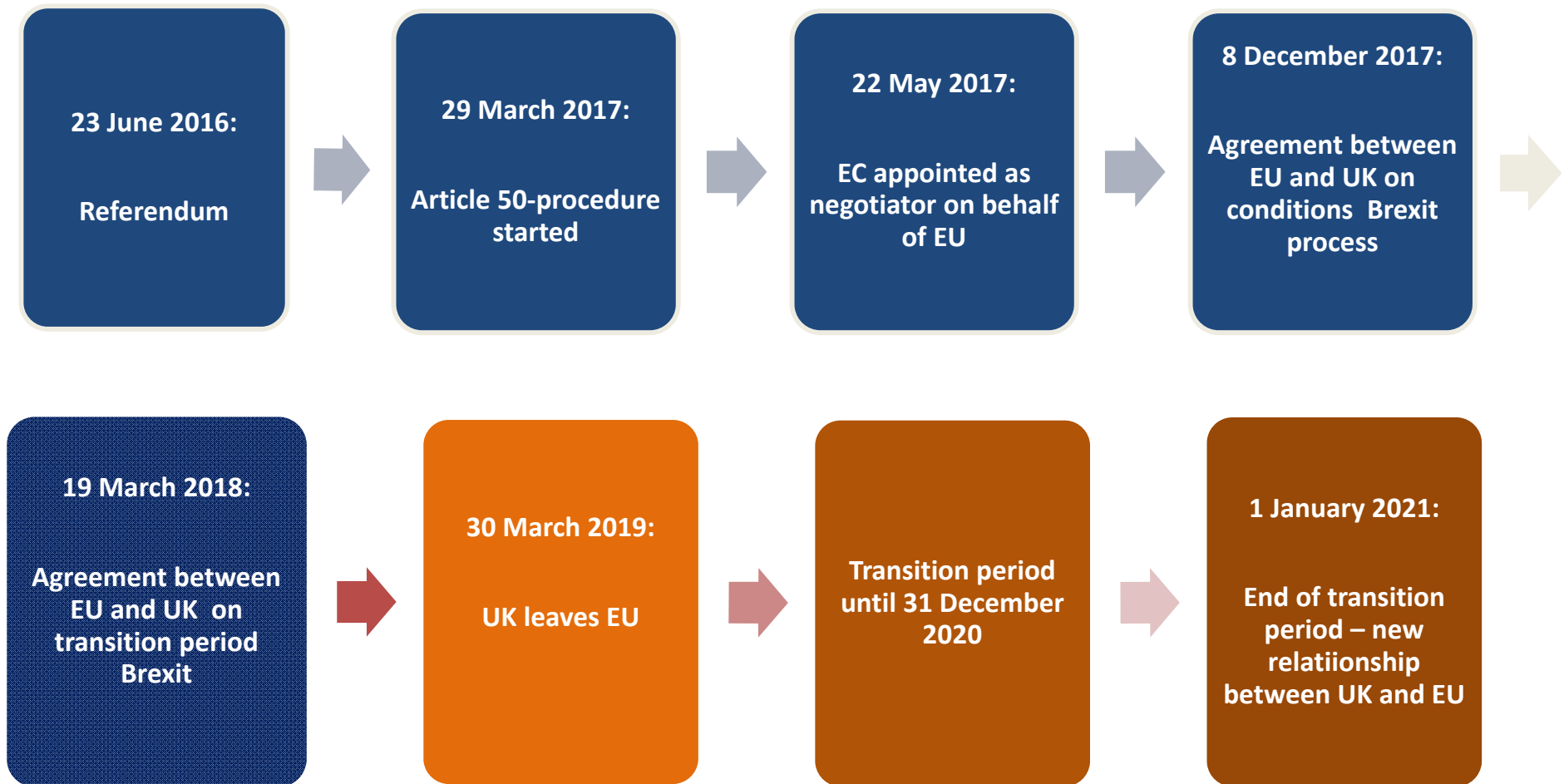
# Structural Change on the Horizon: Brexit and Benchmarks



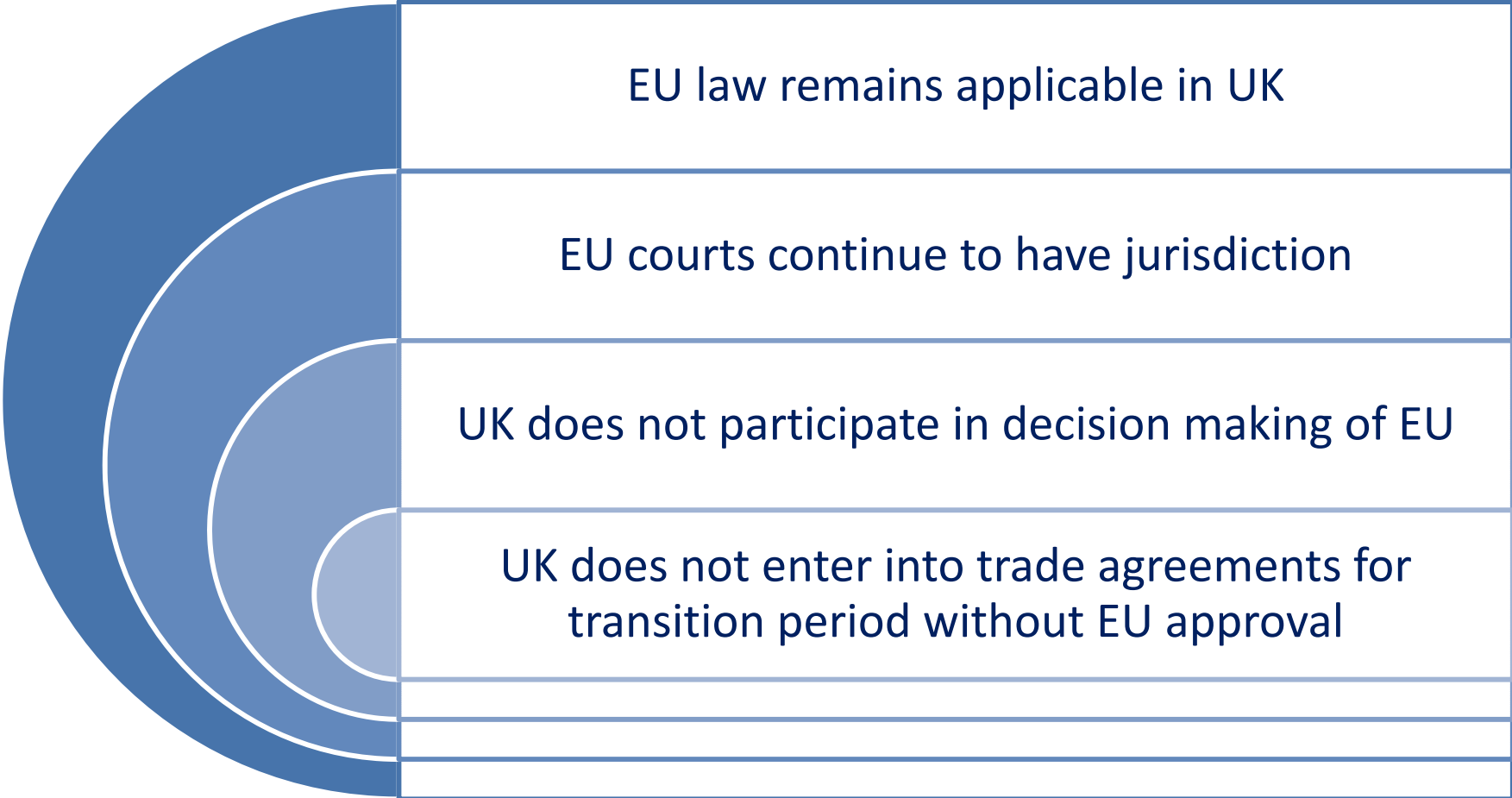
P.R.I.M.E. FINANCE  
Panel of Recognised International Market Experts in Finance

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Professor Pim Rank  
Carolyn H. Jackson  
David E. Sternberg  
Ellen P. Pesch

# BREXIT – WHERE ARE WE NOW?



# TRANSITION PERIOD



# IMPLICATIONS FOR EUROPEAN PASSPORTS

## Point of departure hard Brexit:

- No European passports from and to UK

## EU to UK:

- Incoming passports valid during transition period
- Thereafter license or equivalence required

## UK to EU

- No assurances for transition period
- UK firm must apply for license in EU Member State. License can be passported

Limited exceptions possible – following equivalence decision (Art. 46 – 47 MiFIR)

- MiFID-services to professional clients and eligible counterparties



# IMPLICATIONS FOR EU FIRMS

## Services provided by UK financial undertakings

- ISDA MA with UK investment bank: client relationship?
- Prime Brokerage: MiFiD service?
- Equivalence under UK law for services to professional clients?

## UK Subsidiaries

- Services to other member states

## UK Products

- Investment funds
- Financial instruments / structured products



# IMPLICATIONS FOR TRANSACTIONS - TRADING

## Shares

- Art. 23 MiFIR: Trading obligation for investment firms
- Regulated market, MTF, OTF or equivalent platform

## Derivatives

- Art. 28 MiFIR: trading obligation for derivatives
- Regulated market, MTF, OTF or equivalent platform

## UK platforms

- Not assessed as equivalent yet
- Equivalence uncertain
- Move trading to EU platform?



# IMPLICATIONS FOR TRANSACTIONS – CLEARING

## Clearing obligation

- Article 4 EMIR:
- OTC derivatives transaction for which a clearing obligation applies
- CCP with a license or recognised as third-country CCP

## UK CCP

- Not recognised as third-country CCP yet
- EU firms no longer allowed to clear via UK CCP
- Higher risk weighting for positions of EU banks in CCP (20% instead of 2%/4%)
- Transfer of positions to EU CCP – or equivalent CCP?

## EMIR II

- More powers to ESMA
- More stringent requirements on third-country CCPs



# IMPACT ON CONTRACTS

Choice of law  
Choice of forum

Recognition and  
enforcement of  
judgments

BRRD: Art. 55

ISDA MA governed by  
French or Irish law?





# BREXIT – TAKE AWAYS

Providing financial services in UK?

Providing financial services from UK?

Assess important contracts with UK counterparties

Measures concerning trading and clearing

Monitor developments in equivalence

Check on forum choices for UK courts

Keep calm and carry on



# BENCHMARK INITIATIVES: HOW DID WE GET HERE?

- ❑ 2008 Financial Crisis Exposed Structural Weakness In IBOR Benchmarks
  - E.g., *In re* LIBOR-based financial instruments antitrust litigation, MDL No. 2262 (S.D.N.Y.) -- \$120M settlement
- ❑ 2013: International Organization Of Securities Commissions (IOSCO) Issues Principles To Develop Sustainable And Credible Benchmarks (IOSCO Principles) <sup>1</sup>
- ❑ Mid 2013-2014: Financial Stability Board Considers Applying IOSCO Principles To London Interbank Offered Rate (“LIBOR”) and Other IBORs, And Recommends Reforms<sup>2</sup>
- ❑ June 2016: EU Benchmarks Regulation (BMR) Creates Standards For Benchmarks In Use In The EU As Of January 1, 2020<sup>3</sup>
- ❑ July 2017: UK Financial Conduct Authority (FCA) Announces That It Will Not Compel LIBOR Submissions As Of Year End 2021<sup>4</sup>
  - Market developments contribute to this decision: banks have moved from primary reliance on unsecured, overnight borrowing to use of repos and other financing vehicles; post-crisis liquidity rules penalize use of unsecured financing, collectively leading to fewer underlying LIBOR transactions

## Footnotes:

1. OICU-IOSCO, *IOSCO publishes Principles for Financial Benchmarks* <<https://www.iosco.org/news/pdf/IOSCONEWS289.pdf>>.
2. Financial Stability Board, *Reforming Financial Benchmarks* <<http://www.fsb.org/what-we-do/policy-development/additional-policy-areas/reforming-financial-benchmarks/>>.
3. European Securities and Markets Authority, *Benchmarks* <<https://www.esma.europa.eu/policy-rules/benchmarks>>.
4. Andrew Bailey, *The future of LIBOR*, Remarks at Bloomberg London (Jul. 27, 2017) (transcript available at <<https://www.fca.org.uk/news/speeches/the-future-of-libor>>).



# BENCHMARK INITIATIVES: CURRENT STATUS

- ❑ Now Clear That IBORs Will No Longer Be Broad-Based Benchmarks After 2020
- ❑ Working Groups Created To Identify Alternative Reference Rates (ARRs) To Replace IBORs
  - New IBORs must be derived from transactional data to comply with IOSCO Principles<sup>1</sup>, leading to ARR based on risk-free or near risk-free rates derived from transactions in overnight funding markets
  - Alternative Reference Rate Committee adopts paced transition plan for SOFR (2017)<sup>2</sup>; Sterling Risk-Free Working Group publishes provisional timeline for SONIA (2018)<sup>3</sup>
- ❑ Market Participants Begin To Embrace New Instruments Based On ARRs
  - Issuance/launches pegged to SOFR: CME (May 2018), Fannie Mae (Jul. 2018), The World Bank (Aug. 2018), Barclays (Aug. 2018), MetLife (Aug. 2018) and Credit Suisse (Aug. 2018)<sup>4</sup>
  - Launches pegged to SONIA: ICE (1 and 3-month contracts, Dec. 2017 and Jun. 2018 respectively)<sup>5</sup>
  - S&P classifies SOFR as an “anchor market reference rate” allowing money market funds to invest in SOFR-linked notes<sup>6</sup>

## Footnotes:

1. See *Alternative Reference Rates Committee (ARRC) Minutes for the October 31, 2017 Meeting via conference call*, available at <<https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2017/October-31-2017-ARRC-minutes.pdf>>.
2. See *Working Group on Sterling Risk-free Reference Rates – Timeline with Milestones*, available at <<https://www.bankofengland.co.uk/-/media/boe/files/.../rfr-timeline-with-milestones>>.
3. See *FR07/13 Principles for Financial Benchmarks*, The Board of IOSCO, Jul. 2013, available at: <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD549.pdf>>.
4. CME Group, *CME Group Announces New SOFR Futures Launch Date and Contract Specifications* (Mar. 2018) [https://www.cmegroup.com/media-room/press-releases/2018/3/01/cme\\_group\\_announcesnewsofrfutureslaunchdateandcontractspecificat.html](https://www.cmegroup.com/media-room/press-releases/2018/3/01/cme_group_announcesnewsofrfutureslaunchdateandcontractspecificat.html); Richard Leong, *Fannie Mae issues first-ever SOFR-based securities* (Jul. 26, 2018) <<https://www.reuters.com/article/us-fanniemae-sofr/fannie-mae-issues-first-ever-sofr-based-securities-idUSKBN1KG240>>; The World Bank, *World Bank Launches Market's First SSA Secured Overnight Financing Rate (SOFR) Bond* (Aug. 14, 2018) <<https://www.worldbank.org/en/news/press-release/2018/08/14/world-bank-launches-markets-first-ssa-secured-overnight-financing-rate-sofr-bond>>; Adam Tempkin and Liz McCormick, *Libor Challenger Embraced in Debut Commercial Paper Transaction* (Aug. 27, 2018) <<https://www.bloomberg.com/news/articles/2018-08-27/libor-challenger-embraced-in-debut-commercial-paper-transaction>>; Alex Harris, Paul Cohen, and Rizal Tupaz, *MetLife Breaks Ground With \$1 Billion Bond Based on Libor Heir* (last updated Aug.30, 2018) <<https://www.bloomberg.com/news/articles/2018-08-30/metlife-breaks-ground-with-benchmark-bond-based-on-libor-heir>>; Joe Rennison, *Credit Suisse becomes first bank to issue debt tied to Sofr* (Aug. 20, 2018) <<https://www.ft.com/content/a7f5b21c-a4cd-11e8-8ecf-a7ae1beff35b>>.
5. Intercontinental Exchange, *Managing Interest Rate Risk What to Look for in 2H18* (visited Sept. 27, 2018) <<https://www.theice.com/article/global-interest-rate-policies>>.
6. JOSEPH GIARRATANO and MICHAEL MASI, *The Secured Overnight Financing Rate (SOFR) Is Consistent With Our Principal Stability Fund Ratings Criteria*, S&P Global Ratings RatingsDirect, July 30, 2018.



# BENCHMARK INITIATIVES: LITIGATION RISK

## Challenges Contributing To Litigation Risk

- ❑ Legacy Arrangements Will Likely Have Winners And Losers
  - Notes issued with a floating rate, unless amended, will effectively shift to a fixed rate; future interest rate movements determine winners and losers
  - ARR may not act as perfect hedges – thereby creating financial statement volatility for corporate users that can lead to stock volatility
    - ARR not one-for-one substitutes for current reference benchmarks
  
- ❑ Legacy Contracts Without Appropriate Fallback Provisions Are Susceptible To Enforcement Challenges
  
- ❑ Volume/Scope Of Required Work Is Daunting And The Industry May Not Meet The 2020 And 2021 Deadlines
  - ARR/BMR-approved benchmarks still a work-in-progress
    - Pace of progress varies among jurisdictions
    - Potential for large “bulge in the pipe” at ESMA, slowing down approval of benchmarks targeted for use in the EU
  - Arriving at agreed upon terms
    - Assessment and negotiations of terms (e.g., acceptable ARR, credit premiums, fallback provisions), especially when ARR/BMR-approved benchmarks are still a work-in-progress
    - Securing consent to amendments, especially where consent is required of a retail investor or unanimity is required
  - Exchange transactions (legacy securities for ARR-based securities) take time and are not foolproof

