TRANSITION FROM LIBOR FOR SME CUSTOMERS

Best Practice Guidance

October 2020

The LSB is the primary self-regulatory body for the banking and lending industry.

Our mission is to drive fair outcomes for business and personal customers within financial services through independent oversight of the Standards and Codes for which we are responsible.

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

We work for and on behalf of our members to promote a safe, transparent and innovative banking and finance industry. We offer research, policy expertise, thought leadership and advocacy in support of our work. We provide a single voice for a diverse and competitive industry. Our operational activity enhances members' own services in situations where collective industry action adds value.

With thanks to

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1. Executive Summary

1.1 LIBOR is not expected to remain a suitable reference rate after the end of 2021 and the Working Group on Sterling Risk-Free Reference Rates (the RFR WG) has set a number of targets for firms to meet in transitioning from the London Interbank Offered Rate (LIBOR) to alternative reference rates including: offering non-LIBOR linked products to their customers by the end of Q3 2020; and the conversion (where viable) of existing LIBOR-based products that mature post-2021 by end-Q2/3 2021. The purpose of this document is to make strategic recommendations on good practice for the transition of small and medium-sized enterprise customers (businesses with a consolidated turnover of up to £25 million) to non-LIBOR linked products with the aim of facilitating good customer outcomes and enhancing consistency of approach across the financial services industry. The recommendations in the document have been made taking account of the principles set by the Standards of Lending Practice for business customers, which are overseen by the Lending Standards Board.

1.2 In July 2020, UK Finance surveyed its members to understand the state of their LIBOR transition efforts. The survey revealed a high level of awareness of the RFR WG's expectations and that significant action was, and continued to be, underway across the financial services industry. The report revealed that the scale of the challenge for corporate lending was significant but that substantial steps were being made.

1.3 One of the overarching considerations for the replacement of sterling LIBOR is the selection of alternative reference rates to be used in contracts with customers. The view of the RFR WG is that, for the vast majority of customers in the sterling market, the Sterling Overnight Index Average (SONIA) compounded in arrears is appropriate, however other reference rates may be required, not only for products that require a forward-looking rate (such as trade and working capital products and Islamic Finance instruments), but also for mid-corporate and retail customers where simplicity and/or payment certainty is key. In these customer segments, there is greater optionality in respect of the selection of relevant alternative reference rates, which will have to be navigated by both firms and their customers – whether the customer is entering into a new contract or transitioning an existing contract.

1.4 The three generally recognised alternatives to sterling LIBOR currently are: SONIA compounded in arrears, Bank Rate and Term SONIA Reference Rates (TSRRs) (a fixed rate could also be used as an alternative where appropriate). Each rate has different considerations in respect of its appropriateness for relevant products and customers and in respect to the conventions for the use of each rate (and/or any adjustments thereto) when being used as a replacement for LIBOR. Firms will not only have to consider the practical implications of each rate, but also the conduct risk associated with transitioning customers to an alternative reference rate or offering new products based on alternative reference rates.

1.5 Ensuring customers are suitably informed of the costs, risks and benefits of alternative reference rates to enable them to make an informed choice is key to achieving good customer outcomes. This document looks at steps that can be taken to ensure that customers are sufficiently well informed and that their individual circumstances (including financial difficulty and vulnerability) are taken into account during the transition process, whether they are making changes to an existing contract or entering into a new contract. In the context of LIBOR transition in the SME sector, it is critical that information is tailored to the relevant audience across the spectrum of customer segments and takes into account the customer's individual circumstances and level of sophistication. Clarity and transparency of information are also key factors. In addition, with such a rapidly changing environment, it is important that communications with customers identify areas that could change or develop. Firms will need to ensure that customers have been provided with appropriate materials and information, that the customer has the opportunity to ask questions and, ultimately, that the customer derives a sufficient level of comprehension from the materials and explanations provided.

1.6 Additional considerations and risks come in to play when looking at transitioning customers' existing LIBOR-based products to an alternative reference rate. Firms will need to consider how they will identify contracts that will need to be transitioned, the conduct risk associated with moving to an alternative rate, the costs of amendments, the impact on linked products and how to assess customers' operational readiness.

1.7 Overall, a robust governance approach is required to support efficient LIBOR transition decision making and risk management, ensuring clear accountability that meets regulatory expectations. Firms may want to consider: whether the governance arrangements they have in place to support LIBOR transition ensure regular board and executive-level engagement to support them in discharging their responsibilities; how they can demonstrate that customers are being treated fairly; and how to ensure that all regulatory requirements are being met. Firms will want to consider how to include reporting on issues specific to LIBOR transition into regular reporting and management information and how to ensure that the roles and responsibilities of individuals are clearly defined. Finally, from a product governance point of view, firms will want to adequately consider the needs of their customers and the suitability of products and have controls in place to ensure that any conflicts of interest are being managed effectively.

2. Background

2.1 The Standards of Lending Practice for business customers (the Standards), published in March 2017 and updated in August 2020[1], are a voluntary set of standards which set the benchmark for good lending practice in the UK, outlining the way registered firms[2] are expected to deal with their customers throughout the entire product life cycle. They are overseen by the Lending Standards Board (LSB) and cover businesses customers with a turnover of up to £25 million. The Standards became a 'recognised industry code' by the Financial Conduct Authority (the FCA) on 11 February 2020.

2.2 Following announcements by the FCA[3], it is clear that market participants cannot rely on LIBOR remaining as a suitable reference rate, and even continuing to be published, after the end of 2021. It is therefore necessary to migrate away from using LIBOR prior to the end of 2021. LIBOR currently underpins a large volume of products covered by the Standards. Managing conduct risk and promoting good outcomes for customers are critical elements to effecting a successful migration away from LIBOR in accordance with the principles set by the Standards.

2.3 Progress to ensure the industry's readiness for the end of LIBOR is overseen in the UK sterling market by the RFR WG. The RFR WG set a target for firms to be in a position to offer non-LIBOR linked products to their customers by the end of Q3 2020[4].

2.4 To facilitate the transition, both the LSB and UK Finance wish to champion good outcomes for business customers, which includes meeting the milestones proposed by the RFR WG. The LSB (in its capacity of independently overseeing registered firms to drive fair customer outcomes within financial services), and UK Finance (as the collective voice for the banking and finance industry, working to promote a safe, transparent and innovative industry), believe there is merit in collectively promoting good practice and good customer outcomes during the transition away from LIBOR.

2.5 Feedback from the industry and others has been that such work would support compliance with the FCA's publicly expressed expectations on management of conduct risk during LIBOR transition.

2.6 UK Finance has undertaken an industry survey of firms to better understand LIBOR readiness and transition plans across the industry which included questions about the transition of small and medium-sized enterprises (SME) customers. An overview of the relevant findings of this survey is outlined in Section 4.

1 The August 2020 version of the Standards is available at: https://www.lendingstandardsboard.org.uk/wp-content/uploads/2020/08/Standards-of-Lending-Practice-for-business-customers-August-2020-Covid-update.pdf
2 The latest list of 'registered firms' is available at: https://www.lendingstandardsboard.org.uk/registered-firms/
3 Key speeches and announcements can be found here: https://www.fca.org.uk/markets/libor.
4 Further statement from the RFR WG on the impact of Coronavirus on the timeline for firms' LIBOR transition plans (April 2020): https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfrwg-further-statement-on-the-impact-of-coronavirus-on-timeline-for-firms-libor-transition-plans.pdf?la=en&hash=68299592AF83B04E3BF60BA3209AA9A73522E9D4 and the RFR WG's 2020-21 Top Level Priorities Roadmap (September 2020): https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfr-working-group-roadmap.pdf

3. Scope

3.1 The purpose of this document is to make strategic recommendations to firms on good practice for the transition of SME business customers to non-LIBOR linked products with the aim of facilitating good customer outcomes and enhancing consistency of approach across the financial services industry, taking account of the principles set by the Standards.

3.2 The focus of this document is limited to products covered by the Standards (loans, overdrafts, commercial mortgages, credit cards and charge cards). In the UK market, only loans and commercial mortgages are likely to be impacted by the LIBOR transition however, not all such products will be impacted: many loans and commercial mortgages today reference rates other than LIBOR. References to loans in this document should be taken to refer to bilateral loans. The implications of LIBOR transition for syndicated lending have been extensively addressed by other bodies, including the Loan Markets Association. However, lenders may wish to consider how the good practices described in this document might impact on, or be adapted for, other products, even where those products are not explicitly within the scope of this document.

3.3 SME clients might additionally access other variable rate products, such as asset finance hire-purchase agreements and leases, which are also out of scope of this paper.[5] Nonetheless, the principles and actions set out in this paper may have relevance to such products and, again, firms should consider how they might adapt this best practice guidance for these product classes.

3.4 This document focuses on sterling products. Whilst many of the matters considered in this paper will be relevant to non-sterling products, these products, and multi-currency products in particular, may be subject to a broader and more complex range of considerations.

3.5 The Standards do not cover Invoice Finance and Asset Based Lending (IFABL). UK Finance oversees on behalf of its membership the Invoice Finance and Asset Based Lending Code (the Code), which is mandatory for all UK Finance IFABL members. The Code sets the commitments that IFABL members must meet when providing the following products and associated services: factoring, invoice discounting and asset based lending. The Code, and the products to which it applies, are not in scope for this best practice guide, but relevant firms may wish to consider Commitments 2-4 of the Code[6], as well as the Code more broadly, when developing their LIBOR transition plans.

3.6 This document considers the approach to be taken with respect to different customer segments within the SME space including mid-corporate, small/micro size enterprises, trade and working capital finance customers. Consideration is given to certain factors within these categories e.g. the level of a customer's understanding and knowledge.

3.7 The document, where possible, will take into account current regulatory material e.g. the FCA LIBOR Conduct Q&As[7], and RFR WG outputs (e.g. its paper on the use cases of benchmark rates[8]).

3.8 This document does not constitute formal guidance or standards from either UK Finance or the Lending Standards Board. It is intended as an additional tool for firms to use in their own LIBOR transition programmes.

This document is intended to provide general information only and is not intended to be comprehensive or to provide legal, regulatory, financial or other advice to any person.

Information contained in this document based on public sources has been assumed to be reliable and no representation or undertaking is made or given as to the accuracy, completeness or reliability of this document or the information or views contained herein. None of Lending Standards Board, UK Finance or any of their respective members, officers, employees or agents shall have any liability to any person arising from or in connection with any use of the document or any information or views contained herein.

5 Such products are covered by the LSB's Standards of Lending Products for business customers – Asset Finance
6 Commitment 2. Members shall act with integrity and deal fairly and responsibly with clients and guarantors.
Commitment 3. Members shall provide clients and guarantors with all appropriate information in a timely and transparent manner.
Commitment 4. Members shall ensure that legal documentation issued by them is clearly and unambiguously written.
7 Conduct risk during LIBOR transition: Questions and answers: https://www.fca.org.uk/news/statements/conduct-risk-during-libor-transition-questions-and-answers.
8 The use cases of benchmark rates: compounded in arrears, term rate and further alternatives: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/use-cases-of-benchmark-rates-compounded-in-arrears-term-rate-and-further-alternatives.pdf?la=en&hash=22BA20A8728D9844E5A036C837874CA3E70FEAE1.

4. Overview of Transition Challenge in SME Market

LIBOR transition

Background

4.1 LIBOR transition remains a huge challenge facing UK business, including SMEs. With a significant decrease in the number of transactions on the underlying market that LIBOR represents, this rate has become heavily dependent on the expert judgment of a panel of submitting banks and so is no longer seen as robust and sustainable. In the wake of the LIBOR manipulation claims that came to light in 2012, various submitting banks expressed concerns that their continued submission of data for LIBOR calculation posed a significant risk for them. In July 2017, the FCA announced it had agreed with panel banks that they would continue making LIBOR submissions until the end of 2021.[9] It is now expected that many panel banks will cease to make submissions after 2021, further impacting the representativeness of LIBOR. Announcements are expected either in the run up to, or shortly after, the end of 2021 confirming that LIBOR will no longer be representative, will no longer be published or will be subject to a substantially different methodology (and then only for limited purposes). This means the financial services industry, businesses and consumers have until the end of 2021 in which to transition away from reliance on LIBOR, or risk disruption to their business or financial activity.

Identifying alternatives

4.2 In order to move away from reliance on LIBOR, firms (together with their customers) will need to identify alternative rates. Given the range of uses to which LIBOR is put, it is not generally considered that a single rate can replace LIBOR. Equally, for the same reason, differing calculation conventions may be required in order to use particular alternative rates.

4.3 In the UK, there have been significant efforts to identify and develop alternatives to LIBOR. The RFR WG, a body composed of industry representatives, was convened by the FCA and Bank of England (BoE) in 2015 to implement the Financial Stability Board's recommendation to develop alternative risk-free rates (RFRs) for use instead of IBOR based reference rates. In 2017, the RFR WG selected SONIA as its preferred RFR for use in sterling markets. SONIA, which is produced by the BoE, is perceived to be far more robust than LIBOR as it is based on a large volume of transaction data. Work remains ongoing to produce workable reference rates based on SONIA – please refer to paragraphs 5.10 et seq. (SONIA compounded in arrears) and paragraphs 5.16 et seq. (TSRRs) for further discussion on the development of reference rates based on SONIA.

9 "The future of LIBOR", speech given by Andrew Bailey at Bloomberg, London, 27 July 2017.

How does SONIA differ from LIBOR?		
	LIBOR	**SONIA**
Basis of calculation	Based on the inter-bank wholesale, unsecured funding market, which has seen dwindling transaction volumes. Where there is insufficient transaction data to use for the calculation of LIBOR, the published rate is calculated on the basis of submissions based on the expert judgment of panel banks	Based on the sterling wholesale unsecured deposits market which sees robust transaction volumes
Tenor	Published for seven tenors (overnight, 1 week, 1 month, 3 months, 6 months and 12 months)	Overnight only
Horizon	Forward looking	Backward looking
Publication schedule	Published on or before the first day of the relevant period (T basis for sterling and T-2 for other currencies) at 11am London time	Published on the next business day (T+1 basis) at 9am London time
Risks captured	Incorporates bank credit risk and term liquidity premium	Nearly risk-free
Currencies	Published for USD, GBP, EUR, CHF and JPY	Published for GBP only[10]

4.4 In parallel with the UK, there have been similar initiatives in other jurisdictions with currencies for which LIBOR is calculated.[11] For instance, in the US, the Alternative Reference Rates Committee (ARRC) has recommended transitioning away from USD LIBOR in favour of the Secured Overnight Financing Rate (SOFR).

4.5 Beyond those RFRs endorsed by official sector working groups, there are other alternative reference rates available. For instance, a central bank base rate plus margin may be appropriate for certain products and customer types. Please refer to paragraphs 5.13 et seq. (Bank Rate / base rate) for further discussion of other alternative reference rates.

4.6 Following the development of these RFRs some progress has been seen in the markets. Andrew Bailey, Governor of the Bank of England, noted in July 2020 that the market for SONIA-linked derivatives has become well established; there is now a functioning SONIA-linked bond market, with £16 billion issued this year (in the period running up to July), and March 2020 saw the first multi-currency revolving credit facility linked to both SONIA and SOFR.[12]

4.7 However, while work has begun on the transition away from LIBOR across existing products in derivative and cash markets, considerable work still needs to be done to reduce the huge volume of existing financial contracts written with LIBOR-linked rates.

10 Other RFRs have been identified by the various working parties for the other LIBOR currencies. Please see the paragraph below in relation to the preferred USD LIBOR replacement. For CHF (Swiss Franc) LIBOR the relevant RFR is SARON (Swiss Average Rate Overnight) and for JPY (Japanese yen) it is TONA (aka TONAR) (Tokyo Overnight Average Rate). Clearly, EURIBOR can be used as an alternative to EUR LIBOR, as it is not currently anticipated that EURIBOR will be discontinued. However, there is a RFR in connection with EUR: €STR (Euro Short-Term Rate). Discussion of the ongoing work and recommendations of the Working Group on Euro Risk-Free Rates on, among other things, incorporating robust fallbacks in loans referencing EURIBOR is beyond the scope of this document.

11 USD, EUR, CHF and JPY

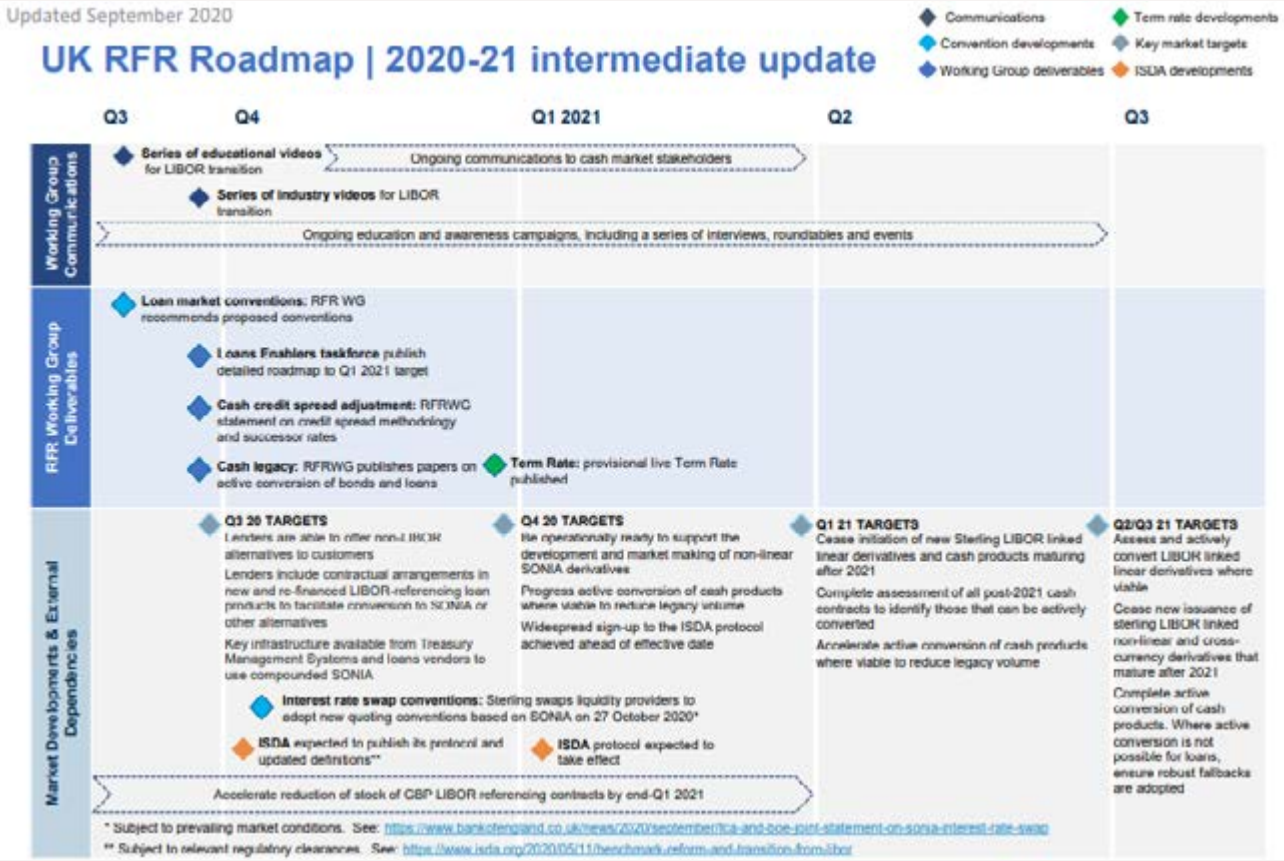
12 "Libor: Entering the Endgame", speech given by Andrew Bailey to Bloomberg Webinar, 13 July 2020.

Transition targets

4.8 The FCA has agreed with those banks that make submissions to LIBOR that they will continue to do so until only the end of 2021.[13] Accordingly, the UK authorities have set a final deadline of the end of 2021, in addition to a range of earlier interim deadlines (please see details below), for firms to complete their transition away from LIBOR in both new and existing products.[14]

4.9 The Covid-19 pandemic has caused significant disruption to financial service businesses, as well as the wider economy, throughout 2020. While recognising that this has caused considerable disruption to the loan market's preparations for the discontinuation of LIBOR, the UK authorities have made it clear that the end of 2021 should remain the ultimate target date for all firms to meet. Indeed, the UK authorities have considered that the disruption seen in financial markets during March 2020 only reinforces the need to reduce dependencies on LIBOR as during this period LIBOR increased due to a perception of heightened credit risk, despite authorities taking action to reduce banks' funding costs.[15]

4.10 Although the ultimate target date has not been changed, the RFR WG has adjusted some of the interim targets on the road to the December 2021 deadline, in recognition of the disruption caused by the pandemic. Most notably, the target for banks and other lenders to stop writing new LIBOR-based loans that mature beyond the end of 2021 has been shifted back from the end of Q3 2020 to the end of Q1 2021. The end of Q3 2020 is a significant milestone however, as the RFR WG set this as the target date for lenders to be able to offer non-LIBOR linked products to their customers. Additionally, following this date, all new and re-financed LIBOR-referencing loan products should include clear contractual arrangements to facilitate a transfer to an alternative rate ahead of the end of 2021, either through pre-agreed conversion terms or an agreed process for renegotiation.[16] Targets have also been set for the conversion of existing LIBOR-based products that mature post-2021, with the aim that reduction in the stock of sterling LIBOR-referencing contracts is accelerated by end-Q1 2021 and active conversion is completed where viable by end-Q2/3 2021.[17] All interim transition targets are set out in the RFR WG roadmap set out below.[18]



13 "The future of LIBOR", speech given by Andrew Bailey at Bloomberg, London, 27 July 2017.

14 FCA, "Impact of the coronavirus on firms' LIBOR transition plans", 25 March 2020. Available at: https://www.fca.org.uk/news/statements/impact-coronavirus-firms-libor-transition-plans

15 Bank of England "Interim Financial Stability Report", May 2020: https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2020/may-2020.pdf

16 Further statement from the RFR WG on the impact of Coronavirus on the timeline for firms' LIBOR transition plans: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfrwg-further-statement-on-the-impact-of-coronavirus-on-timeline-for-firms-libor-transition-plans.pdf?la=en&hash=68299592AF83B04E3BF60BA3209AA9A73522E9D4

17 Q&A for Working Group's end-Q3 2020 loans milestone, RFR WG: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfr-working-group-q-and-a.pdf?la=en&hash=D7030E282C4E7579A1CD6ADFFE56D2CACF005A0F. Updated July 2020: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfr-working-group-roadmap.pdf?la=en&hash=92D95DFA056D7475CE395B64AA1F6A099DA6AC5D.

18 https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfr-working-group-roadmap.pdf?la=en&hash=92D95DFA056D7475CE395B64AA1F6A099DA6AC5D

"Tough legacy"

4.11 Despite this drive for progress, difficult issues remain. The RFR WG's "Tough Legacy Taskforce" (TLT) published a paper in May 2020 outlining the type of arrangements that are less likely to convert from LIBOR.[19] Of particular relevance to SMEs, this included bilateral loans and mortgages whose terms may include no existing fallback and require both borrower and lender consent for amendments. Having fewer resources, borrowers in this segment are also generally less attuned to LIBOR transition than larger corporates in the syndicated market. Given these difficulties, the TLT called on the authorities to consider legislation to assist those who cannot transition.

4.12 Following the TLT's proposal, the government intends to legislate to provide the FCA with new powers to manage any wind-down period prior to LIBOR's cessation in a way that protects consumers and/or ensures market integrity.[20] This will be achieved through the forthcoming Financial Services Bill.[21] Despite this development, the UK authorities have stressed that a market-led transition for the bulk of financial contracts remains imperative, both because parties who rely on regulatory action will not be able to control the economic effects on their financial arrangements and because such regulatory action may not be feasible in every circumstance. This means that the onus still rests on the industry to complete active conversion of legacy LIBOR products where viable within the timeframes set by the RFR WG. Please refer to paragraph 7.22 et seq. (Determine if there are any contracts left which cannot be amended) for further discussion of how this issue might be managed in practice.

UK Finance survey

4.13 In July 2020, UK Finance surveyed its members to understand the state of their LIBOR transition efforts.[22] In summary, the survey revealed a high level of awareness of the RFR WG's expectations for market progression towards end-2021 and that significant action was, and continued to be, underway across the financial services industry.

4.14 The survey covered a number of products and customer segments, and in particular revealed that the scale of the challenge for corporate lending was significant. However, substantial steps were being made particularly in the development of products referencing alternative rates. When looking specifically in relation to loans for smaller corporates, ninety-seven per cent of firms expected to have started development of non-LIBOR products by the end of 2020, with the majority aiming to be largely complete by this point. Over half of all respondent firms expect their LIBOR exposure to reduce to some extent by the end of 2020, but the greatest proportion of active transition of legacy contracts across product segments was anticipated to take place in 2021.

4.15 In line with RFR Working Group expectations, though SONIA compounded in arrears was identified as the primary alternative rate being considered for both the development of new products and the transition of sterling LIBOR contracts, it was by no means the only one with other alternative rates such as Bank Base Rate being considered as more appropriate by many firms for some product segments.

4.16 Where engagement with clients had already started, eighty-two per cent of respondents confirmed they had shared general information about LIBOR transition, sixteen per cent had shared client specific information (e.g. which rates they may be offered or transitioned to), and twenty-six per cent had shared other information. The data reflects that there is still progress to be made in terms of customer-specific communications.

4.17 The survey showed a strong acknowledgement of the need to ensure good customer outcomes at the smaller end of the business lending spectrum, with references to the importance of firms receiving adequate guidance to achieve this. In the pursuit of these good outcomes, the survey results across the product segments highlighted a need for a concerted step-up in customer engagement to ensure the transition away from LIBOR is progressed at pace. However, it was the smaller corporate segment of the borrowing community that respondents felt required the clearest outreach and education approach to encourage engagement with the transition process.

The role of SMEs

4.18 There has been widespread recognition of the importance of businesses of all sizes and types stepping up their preparations for LIBOR cessation. In March 2020, the BoE and the FCA wrote to non-financial trade associations[23] stressing the significance of LIBOR transition with regard to the impact it will have on the vast majority of British businesses. Along with sign-posting relevant resources, the BoE and the FCA urged the trade

19 "Paper on the Identification of Tough Legacy Issues", the RFR WG, May 2020: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/paper-on-the-identification-of-tough-legacy-issues.pdf

20 Written statement made by Rishi Sunak, Chancellor of the Exchequer, 23 June 2020.

21 https://publications.parliament.uk/pa/bills/cbill/58-01/0200/200200.pdf

22 UK Finance 'LIBOR Transition Readiness Survey' (member-access only) https://www.ukfinance.org.uk/policy-and-guidance/reports-publications/libor-readiness-transition-survey

23 See: https://www.bankofengland.co.uk/-/media/boe/files/letter/2020/how-the-discontinuation-of-libor-may-affect-your-members-and-stakeholders.pdf?la=en&hash=D9A81997BE52277310381903350FF1754495657E.

associations to assist the UK authorities in raising awareness amongst their networks, ensuring businesses are alert to the fact they may need to take action in order to avoid disruption where they have exposure to LIBOR. The BoE's letter identified 2020 as the critical year for this end-user engagement to begin, starting with identification, and then progressing to the removal, of dependencies on LIBOR. It was stressed that while businesses with LIBOR-linked financial contracts would be contacted by their lenders, it remained important that businesses themselves seek awareness of the extent to which LIBOR is embedded within their business and the steps they would need to take to effect transition.

4.19 In conjunction with this letter, the RFR WG, the FCA and the BoE also published a factsheet[24] in conjunction with the Association of Corporate Treasurers and the Confederation of British Industry. This explained the background to the LIBOR transition, as well as providing practical guidance encouraging firms to: establish their LIBOR exposures; check their contractual terms; familiarise themselves with SONIA; and speak to their bank, product provider or financial advisor about the preparations they are making. In his recent speech, Andrew Bailey underlined this point by providing direct advice to businesses. He stated:

"I'd suggest if you are borrowing past the end of 2021 you consider seriously the greater certainly that those alternatives [to LIBOR] offer. If you do decide to borrow linked to Libor then your bank should discuss how that contract will change from Libor to an alternative rate ahead of the end of 2021. We would not expect to see any further sterling Libor linked lending after the end of March 2021."

4.20 As this message spreads, business will expect their financing providers to work with them through LIBOR transition. In September 2020 UK Finance, in collaboration with Confederation of British Industry, relaunched a 'Discontinuation of LIBOR - Guide for Business Customers' to help promote greater awareness of LIBOR transition amongst businesses and set out the necessary steps they need to consider to prepare for conversations with lenders.[25]

4.21 It is in the interest of both lenders and borrowers that the LIBOR transition is treated as a two-way process and that SMEs engage with the transition, even where lenders are taking a leading role.

24 See: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/factsheet-calling-time-on-libor-why-you-need-to-act-now.pdf.

25 Discontinuation of LIBOR - Guide for Business Customers (September 2020) https://www.ukfinance.org.uk/system/files/LIBOR-Guide-for-Business-Customers-SEPTEMBER%202020-FINALpdf.pdf

5. Selecting Replacement Reference Rates

5.1 One of the overarching considerations for the replacement of sterling LIBOR is the selection of alternative reference rates to be used in contracts with customers. The overall view of the RFR WG (as set out in its publication "Use Cases of Benchmark Rates: Compounded in Arrears, Term Rate and Further Alternatives"[26] (the Use Cases Paper)) is clear: for the vast majority of customers in the Sterling market (representing around ninety per cent by value), SONIA compounded in arrears is appropriate and introducing this as a replacement for LIBOR is likely to be operationally achievable. However, for the remaining ten per cent, the RFR WG has concluded that other reference rates may be required.

5.2 The Use Cases Paper envisages that this remaining ten per cent (by value) will be made up of mid-corporate (revenue <£25 million) and retail customers, for whom simplicity and/or payment certainty is a key factor, as well as those products that require a forward looking rate (trade and working capital products which use discounted cash flows and Islamic Finance instruments). Clearly a significant proportion of this cohort falls under the scope of the Standards and this document. In these customer segments, there is greater optionality in respect of the selection of relevant replacement reference rates, which will have to be navigated by both firms and their customers.

5.3 Questions as to which rates are selected, how this process is undertaken and how best to ensure customers are making fully informed choices, will have similar underlying characteristics whether the customer is entering into a new contract or transitioning an existing contract.

Key points for consideration when selecting an appropriate replacement reference rate for a customer

5.4 The FCA statement on Conduct risk during LIBOR transition[27] sets out its expectations when selecting an alternative reference rate for transitioning existing contracts, including:

- LIBOR discontinuation should not be used to move customers with continuing contracts to replacement rates that are expected to be higher than what LIBOR would have been, or otherwise introduce inferior terms.
- When transitioning their existing contracts, firms receiving LIBOR-linked interest are not expected to give up the difference between LIBOR and SONIA, which results from the term credit risk premium that is built into the LIBOR rate, but not into SONIA.
- Firms that insert "hardwired fallback", or rate switching provisions, in existing contracts to replace LIBOR with a new reference rate should ensure they communicate effectively how these fallback provisions are expected to operate.
- Firms will also need to consider whether any contract term they may rely on to amend a LIBOR-related product is considered to be 'fair' under the Consumer Rights Act 2015 (the CRA)[28] in respect of consumer contracts.

5.5 The associated question and answers also say that when offering new products firms should:

- take care in describing to the customer the risks associated with LIBOR ending and how it will affect them;
- be aware that there is a risk that some customers may not fully understand the implications.

5.6 Firms continuing to offer LIBOR-linked products that mature after the end of 2021 will need to carefully consider whether these products can:

- meet the needs of customers, and
- continue to perform as customers are led to expect, both leading up to and following the discontinuation of LIBOR.

5.7 These themes are further expanded through Sections 6 and 7.

Alternative reference rates

5.8 In terms of the alternative reference rates themselves, there are currently three generally recognised alternatives which firms may want to consider for use as a replacement benchmark for sterling LIBOR: SONIA compounded in arrears, Bank Rate and TSRRs. A fixed rate could also be

26 See: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/use-cases-of-benchmark-rates-compounded-in-arrears-term-rate-and-further-alternatives.pdf?la=en&hash=22BA20A8728D9844E5A036C8378874CA3E70FEAE1.

27 See: https://www.fca.org.uk/markets/libor/conduct-risk-during-libor-transition.

28 The Unfair Terms in Consumer Contracts Regulations 1999 (the UTCCR) will be relevant for consumer contracts entered into prior to 1 October 2015 and amended by way of unilateral variation (rather than by way of an agreement with the customer).

used as an alternative where appropriate to meet the needs of a customer.[29] The daily SONIA rate can also be used without compounding in products that currently reference the overnight tenor of LIBOR.

5.9 It is worth bearing in mind that, for some customers, the availability of suitable hedging products for use in connection with loans referencing particular alternative reference rates may be an important factor when selecting an alternative reference rate.

SONIA compounded in arrears

5.10 The RFR WG has finalised conventions around SONIA compounded in arrears. The RFR WG's summary of recommendations is outlined below:

- SONIA compounded in arrears remains the recommended alternative to sterling LIBOR, implemented via a compounded in arrears methodology, and loan markets should now move consistently towards this.
- Use of a five banking days lookback without observation shift[30] is recommended as the standard approach.
- Where an interest rate floor is used, the RFR WG recognises that it may be necessary to apply the floor to each daily interest rate before compounding.
- Regarding prepayments, the RFR WG recommends that accrued interest should be paid at the time of principal prepayment.[31]

However, it is important to note that, while the RFR WG has recommended five banking days lookback without observation shift as the standard approach for SONIA compounded in arrears, the RFR WG also proposed that, "where lenders are also able to offer lookback with an observation shift this remains a viable and robust alternative" and "it is recognised that in certain transaction or client-specific circumstances an alternative methodology or rate may be more appropriate or convenient".[32]

The Standards require firms to "ensure that clear information is provided as to how the product on offer works: its key features and the associated costs for example, charges, interest and any breakage or early repayment fees/costs"[33]. Firms may still need to be transitioning towards using alternative reference rates despite this lack of certainty, and firms may want to address the evolving nature of this process in continuing information campaigns with customers.

5.11 With regard to how to incorporate compounded SONIA before the systems infrastructure is in place, within the syndicated loan market and increasingly across other markets, there is an increased interest in the use of "hardwired fallbacks" or rate switching mechanisms. In both cases, this allows new loans to be entered into on a LIBOR basis initially, but with an in-built mechanism that switches to SONIA compounded in areas at a later date. This type of provision can be used in new contracts or incorporated into existing contracts through an amendment process. Please see paragraphs 6.19 et seq. (Rate switch mechanisms) for further discussion on rate switching mechanisms.

5.12 Compounded SONIA and LIBOR perform differently and reflect different risks. As a result, firms are likely to look to include a credit adjustment spread in a SONIA-based interest rate calculation in order to minimise any economic value transfer where transitioning existing LIBOR based contracts or using a rate switching mechanism (please also see paragraphs 6.16 et seq (Credit adjustment spread or margin increase?) for discussion on the use of credit adjustment spread / incorporation of credit premia in new contracts).

5.13 The RFR WG has consulted on the methodology to be used for calculating a credit adjustment spread for use where SONIA compounded in arears replaces sterling LIBOR in cash products where this is triggered by the cessation or non-representativeness of LIBOR.[34] The consultation has led to a recommendation from the RFR WG to use the historical five-year median spread.

5.14 Active transition (i.e. transition from LIBOR to an alternative reference rate in advance of LIBOR either ceasing to be published or becoming non-representative) may require consideration of an additional factor: as transition under different contracts could occur at different times, the methodology used to calculate the spread may

29 Current market practice is such that most fixed rates loans will be fixed against a LIBOR hedge. Fixed rate loans in future may therefore need to be hedged against an alternative benchmark rate. See Section 4(c)(ii) for guidance on hedging.

30 Lookback without observation shift is also known as the observation lag convention.

31 RFR WG, Statement on behalf of the Working Group on Sterling Risk-Free Reference Rates – Recommendations for SONIA Loan Market Conventions (September 2020): https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/statement-on-behalf-of-rfrwg-recommendations-for-sonia-loan-market-conventions.pdf?la=en&hash=074583D7080993CE84B6A381B554BEFD6594C076.

32 RFR WG, Statement on behalf of the Working Group on Sterling Risk-Free Reference Rates – Recommendations for SONIA Loan Market Conventions (September 2020): https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/statement-on-behalf-of-rfrwg-recommendations-for-sonia-loan-market-conventions.pdf?la=en&hash=074583D7080993CE84B6A381B554BEFD6594C076.

33 Paragraph 5, Standards on Product Information (Lending Standards Board Standards of Lending Practice for business customers).

34 Consultation on credit adjustment spread methodologies for fallbacks in cash products referencing GBP LIBOR: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/consultation-on-credit-adjustment-spread-methodologies-for-fallbacks-in-cash-products-referencing-gb.pdf. Summary of responses - Consultation on credit adjustment spread methodologies for fallbacks in cash products referencing GBP LIBOR: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/summary-of-responses-on-consultation-credit-adjustment.pdf Statement on behalf of the Working Group on Sterling Risk-Free Reference Rates – Recommendation of Credit Adjustment Spread Methodology for fallbacks in cash market products referencing GBP LIBOR: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/recommendation-of-credit-adjustment-spread.pdf?la=en&hash=3F7198EBBE9866DC362B6F6BAF6BEE91F7C2AA58

produce different results, depending on the date of transition. This could potentially lead to disparities between the credit adjustment spreads applicable to different customers creating inconsistent outcomes.

5.15 Firms should make their own assessment on the approach to take for different customers/clients. Firms should monitor ongoing guidance from the RFR WG and FCA on approaches to active transition and consistency with treating customers fairly.

Bank Rate/base rate

5.16 Firms lending to the SME sector may wish to offer Bank Rate (sometimes referred to as Base Rate) as an alternative to LIBOR. As with SONIA compounded in arrears, when amending legacy contracts to include Bank Rate, firms are likely to look to include a credit adjustment spread to the interest rate calculation in order to minimise any economic value transfer between LIBOR and Bank Rate (please see paragraphs 6.16 et seq (Credit adjustment spread or margin increase?) for discussion on the use of credit adjustment spread in new contracts).

While SONIA and Bank Rate are more closely aligned than other rates, using the same credit adjustment spread as the one used to transition from LIBOR to compounded SONIA may not be appropriate, and firms may need to consider how to apply a credit adjustment spread for this cohort..

5.17 Some market participants may also be considering the use of their own internally managed base rates, and this may mean that any officially recognised Bank Rate to LIBOR spread may not be appropriate. As such, any common calculation methodology may need to take this possibility into account. It will be particularly important for those firms using their own individual base rates and credit spreads to carefully manage situations where use of such rates may result in an economic transfer in their favour when the rates are applied to legacy LIBOR contracts.

5.18 In the absence of any market-wide common methodology, firms may want to adopt a consistent internal methodology. This methodology should be transparent and clearly communicated to customers prior to concluding the amendment of a legacy contract or the entry into a new lending agreement, as applicable. Firms will need to be able to clearly demonstrate that any credit adjustment spread used is fair, that customers will not be disadvantaged, and that the product will continue to perform as expected.

Term SONIA Reference Rates (TSRRs)

5.19 According to the RFR WG's Use Cases Paper, in addition to products that require a forward looking rate (such as trade finance and Islamic finance products), the use of TSRR may also be appropriate in other products for customers in the SME sector where simplicity or payment certainty is the key factor.

5.20 The RFR WG has indicated that TSRRs are expected to be available for market participants to use before the end of the Q1 2021 deadline for ceasing sterling LIBOR issuance.[35] At the time of writing there are currently three providers who have made a "beta" rate available, but no live rates. Firms may need to consider how this will impact the development of new product offerings from Q4 2020 in areas of the market which would require forward-looking rates.

5.21 Firms may investigate alternatives to TSRRs even within areas which need a term rate so that in the event no TSRR is available at the relevant time or no TSRR that is suitable for that firm's purposes (or for a particular product range or customer base) becomes available, they can continue to work towards the milestones set by the RFR WG.

5.22 Recent RFR WG guidance[36] has clarified how their targets apply to trade finance products requiring a TSRR. The targets to offer non-LIBOR linked products to customers by the end of Q3 2020, and to cease all new issuance of sterling LIBOR-referencing loan products that expire after the end of 2021 by the end of Q1 2021, remain in place even where no TSRR is available. However, in respect of those transactions maturing beyond 2021 but where the last reference rate fixing/discount rate occurs before the end of 2021, these could still be issued beyond the end of Q1 2021. After Q3 2020, where no TSRR is available, clear contractual conversion arrangements should be included in all new and re-financed LIBOR-referencing trade financing products maturing after the end of 2021. For this purpose, the RFR WG suggests firms could consider an arrangement whereby the transaction switches to a TSRR, if appropriate and available, and, if not, to an alternative reference rate, such as Bank Rate.

35 Bank of England RFR WG Q&A for Working Group's end-Q3 2020 loans milestone (28 July 2020).
36 Bank of England RFR WG Q&A for Working Group's end-Q3 2020 loans milestone (28 July 2020).

6. Engaging with Customers on Alternative Reference Rates

6.1 Whether firms are seeking to amend contracts for existing lending arrangements or offering new products, the move towards products based on alternative reference rates is a unique challenge for lenders and borrowers alike. This is primarily due to the range of alternative reference rates available; the complexities and uncertainties connected with some of those alternatives; and the general lack of awareness among borrowers. Ensuring customers are suitably informed of the costs, risks and benefits of alternative reference rates to enable them to make an informed choice is key to achieving good customer outcomes.

6.2 This section looks at steps that can be taken to ensure that customers are sufficiently well informed and that their individual circumstances are taken into account during the transition process, whether they are making changes to an existing contract or entering into a new contract.

General approach to providing information to customers

Tailoring information to the customer

6.3 In the context of LIBOR transition in the SME sector, it is critical that information is tailored to the relevant audience across the spectrum of customer segments. Firms may want to consider producing a range of materials that take into account the needs, objectives, experience and understanding of each customer segment. A wide range of different communications might be required. It should be assumed that not all customers will have the same knowledge, or expertise, to handle the transition.

Firms will have different interpretations and definitions of what constitutes a customer segment for their business, but within the SME space this may include mid-corporates, small/micro-size enterprises and trade and working capital finance customers. Firms may wish to take into consideration their current operating model and how customer segmentation is currently dealt with internally when looking at communication strategies to deal with LIBOR transition.

Pursuant to the Standards:

- Firms should ensure that customers are provided with clear and understandable information which enables them to decide whether the product they are considering applying for meets their needs and is appropriate for the type of business they are engaged in.[37]
- Firms should ensure that clear information is provided as to how the product on offer works: its key features and the associated costs for example, charges, interest and any breakage or early repayment fees/costs.[38]
- Where a customer's borrowing is linked to an interest rate benchmark and this will be transitioned to an alternative rate, firms should ensure that customers are provided with timely notification of when this change will become effective and firms should ensure that any changes to the terms of the customer's agreement are fair and transparent.[39]
- The customer should be provided with clear information regarding the reason for the changes and provided with a reasonable amount of time to seek further clarification, or where appropriate, alternative sources of finance.[40]

37 Paragraph 3, Standards on Product Information (Lending Standards Board Standards of Lending Practice for business customers).

38 Paragraph 5, Standards on Product Information (Lending Standards Board Standards of Lending Practice for business customers). Please also note that Paragraph 7, Standards on Products sale requires that "At the point of sale, firms should provide clear information to the customer regarding the key features of a product and any breakage or early repayment fees/costs associated with it. This information should be made available to the customer upon request, throughout the lifetime of the borrowing".

39 Paragraph 4, Standards on Product execution (Lending Standards Board Standards of Lending Practice for business customers).

40 Paragraph 9, Standards on Product execution (Lending Standards Board Standards of Lending Practice for business customers).

How each firm currently deals with particular segments may be an additional factor to take into consideration. For example, communications strategies may differ between segments that have a relationship manager function, and those that do not. Of course, that is not to say that additional compartmentalisation within existing customer segments or strategies that overlap certain segments should not also be considered in relation to LIBOR transition.

6.4 LIBOR transition remains a quickly evolving and complex area. Therefore, firms may also wish to bear in mind that even where customers in a particular segment would generally be expected to have a sophisticated grasp of financial matters, knowledge cannot be assumed in all relevant aspects of LIBOR transition. In addition, care must be taken to ensure that less sophisticated customers are not overwhelmed by the detail or volume of information and are given sufficient time to work through the information and its consequences.

6.5 The sophistication of a customer's treasury function is likely to have significant impact on the way in which that customer will engage in the LIBOR transition process. The SME customer base is broad in nature and will contain customers with a wide range of treasury knowledge. A larger, more sophisticated SME in the mid-corporate segment that has a multi-national focus, in terms of both product production and placement, could be expected to have borrowing and deposit facilities in numerous currencies across a number of different banks.

Such an SME may have a specialist treasury function that would manage the LIBOR transition. This process may extend to other IBORs, so the communication strategy would have to be tailored to encompass the customer's overall needs. Due to the sophistication of this type of customer, transition is more likely to focus on SONIA compounded in arrears as an alternative reference rate, with customers having to review their systems to accommodate this within their overall finance function. This process could come with a variety of lead times for each customer, so it is likely the customer's LIBOR transition options will need to be discussed and analysed in good time. The information requirements for such customers are likely to be extensive.

On the other hand, a smaller/micro sized enterprise that is domestically focused will most likely have banking facilities in GBP only, with one bank or a very small group of banks. These customers are unlikely to have a separate treasury function, as these duties will most likely be absorbed by the finance function. Therefore, the base level of knowledge in respect of the LIBOR transition is likely to be lower. This could translate into a reduced level of customer engagement and appreciation of the potential company system changes that might be required. Whether this segment will use SONIA compounded in arrears could be dependent on the expertise within each individual customer's finance function. While the information requirements for this customer segment could also be quite extensive, as it is unclear which of the alternative approaches will be the most appropriate for each customer, the focus and depth of this information may differ significantly from those customers with a more sophisticated treasury knowledge.

6.6 Customers at the smaller end of the SME sector, where trade and working capital facilities are provided, could be managed by the business owners and have only a small number of employees. Specialist finance knowledge cannot be assumed and engagement from the initial communications could be very low. The customer will need to be informed about the alternative reference rates available, with a suitable level of information provided on each, in order that customers in this segment can fully review the options.

6.7 Throughout the process of producing materials for customers, and at all stages of the engagement with customers, firms may want to take account of, and highlight, circumstances which would drive different approaches across these segments.

6.8 Strategies for ensuring that information provided to customers is at an appropriate level, may include:

- Phasing communication so that initial communications are aimed at raising customer awareness of the need for transition and broadly what that will mean for them. Later communications would then be more targeted based on customer segment. The final stage would then be further refined to the customer's individual needs and products.
- Using a 'key terms' approach to explain the different conventions and methodologies across the alternative benchmarks. This can then be supported with further detail and calculation examples so customers can look deeper into the alternative rates to understand how firms will calculate interest and adjustment spreads. Comparisons with LIBOR could be helpful to explain the different construction of alternative reference rates and the relative historical behaviour of the rates over a period of time.
- Providing a range of different formats can be very helpful (such as short factsheets, longer customer guides, webinars, presentations, FAQs, worked examples, graphics).

Case Study A: Communications and Engagement Strategy

Firm X adopts an external communications and engagement strategy specifically for SMEs which differs from that being employed for larger, more sophisticated customers.

Firm X's communication approach involves a number of different engagement activities over a phased period, which collectively provides customers with the full range of information they require to make an informed decision on the best transition path and replacement benchmark to meet their needs.

Communication methods may include:

- Dear client letter/memo – direct letters to customers highlighting specific upcoming milestones, the implications of LIBOR transition, and next steps to contact Firm X for further discussions or to submit queries.
- External FAQs – publication of a library of FAQs and answers on Firm X's website.
- Newsletter or bulletin – provision of LIBOR transition updates on an ongoing basis throughout the transition period.
- Client training – several interactive webinars explaining the implications of LIBOR transition in clear and simple terms by product, incorporating time for Q&A from participants. These webinars are subsequently published on Firm X's website to reach broader audiences.
- Individual customer outreach – multiple attempts to contact customers to review individual portfolios and agree their transition approach, path and timing.

Any materials presented to customers are, where necessary, tailored to take account of the relevant customer's sophistication and ability to understand what is being asked of them. Firm X also ensures that its external communication is undertaken concurrently with internal training of frontline staff to adequately prepare them for queries received from customers as a result of Firm X's outreach.

Clarity and transparency

6.9 Clarity and transparency of information are also key factors in communications with customers in the context of LIBOR transition. Firms may ensure that the method of calculation of interest and the most likely operational impacts this will have are effectively communicated. One of the many challenges of LIBOR transition is that recommendations are still emerging from industry bodies like the RFR WG around the use of various alternative reference rates, the calculation conventions that might apply and any credit adjustment spreads that may be applied (whether in transitioning legacy contracts or entering new contracts) and firms still need to make their own determinations on the appropriate approach to take on rates and spreads for legacy and new products. At the time of writing the exact timing of the availability of certain rates, particularly a TSRR (see paragraph 5.20 above), has not been confirmed. A further challenge for legacy contract remediation is that no single alternative reference rate and credit adjustment spreads methodology will be appropriate for all customers thereby simplifying the choices firms make available. With such a rapidly changing environment, it is important that communications with customers identify areas that could change or develop. Firms may want to plan for increasing levels of engagement with customers as industry-agreed timelines draw nearer.

Use of existing materials

6.10 Firms may choose to use existing materials developed by industry working groups where available and appropriate. For example, the publicly available factsheet "Calling time on LIBOR: Why you need to act now"[41] and the CBI / UK Finance publication "Discontinuation of LIBOR – Guide for Business Customers"[42] may be useful tools to raise customer awareness. However, it is recognised that many of the more technical documents are unlikely to be easily digested by most customer segments within the SME space.

41 Published by the RFR WG in conjunction with the BoE, the FCA and others (January 2020): https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/factsheet-calling-time-on-libor-why-you-need-to-act-now.pdf

42 https://www.ukfinance.org.uk/policy-and-guidance/reports-publications/discontinuation-libor-guide-business-customers

Clear, fair and not misleading

6.11 To ensure that all customer communications relating to LIBOR transition are clear, fair and not misleading:

- firms should describe the risks and impacts from LIBOR discontinuation for existing legacy LIBOR-linked products;
- where alternative options are presented for new products, or to change existing legacy LIBOR-referencing contracts, any range of options should be reasonable and fairly presented, including the associated benefits, costs and risks;
- communications should not disguise, reduce or hide relevant information; and
- firms should consider the knowledge and experience of the intended audience.[43]

6.12 As a general matter, information about LIBOR cessation and alternative benchmark products should be presented to customers in good time to allow customers to make informed decisions about relevant products (including amendments to legacy contracts) and the risks they entail, including the opportunity to consider alternative products with other providers.

6.13 Frontline staff will be instrumental in ensuring customers are well informed and that feedback on the materials provided to customers is appropriately considered. This aspect is considered further in paragraphs 6.24 et seq. (Ensuring frontline staff are sufficiently knowledgeable and supported).

Informing customers on the calculation and conventions for alternative reference rates

Alternative reference rates

6.14 In communications with customers, it will be necessary to describe the alternative reference rate being used as a replacement for LIBOR in an appropriate level of detail, accounting for each customer's (or customer segment's) level of knowledge and understanding and, in addition, the range of factors relating to the alternative rate that may have a material effect on the customer.

6.15 Where a firm proposes to use a TSRR, it will be particularly important to emphasise that although TSRRs reproduce the forward-looking term rate nature of LIBOR they are based on transaction information from a very different market (i.e. derivatives rather than the interbank market) and are not simply the "new LIBOR". Firms may also want to make customers aware that TSRRs may perform differently over time than other alternatives such as Bank Rate. As recommended in paragraph 6.9 above, firms may need to clearly communicate with customers in areas where there is an element of uncertainty around the availability of rates or the formation of an industry consensus so that the customer has time to make informed decisions. This is particularly true in respect of the availability of TSRRs.

Credit adjustment spread or margin increase?

6.16 As mentioned above in paragraphs 5.12 and 5.16, where compounded SONIA or Bank Rate are being used as an alternative reference rate, firms may be considering the use of credit adjustment spreads when transitioning legacy products or including a rate switching mechanic to minimise any economic value transfer on transition from LIBOR to an alternative reference rate.

6.17 In contrast, for new contracts firms may be considering either adding a spread component or increasing the margin to incorporate a credit risk premia similar to that inherent in LIBOR or to reflect firms' cost of borrowing. Although increasing the margin to take account of these factors would simplify the interest rate provisions, it does carry with it a number of other considerations. Firstly, firms should consider whether an appropriate level of clarity and transparency can be maintained when using this method, particularly where customers are making comparisons directly to a LIBOR rate. Secondly, this can have an impact on certain other aspects of the product terms.

For instance, where zero rate flooring is used: if a zero rate floor is applied to the reference rate, plus a credit adjustment spread, this will give a different result to a zero rate floor applied to the reference rate alone in circumstances where the margin has been increased instead of the use of a credit adjustment spread. Similarly, there will be an impact where fees are calculated on the basis of the margin.

6.18 Whichever method is adopted for new contracts based on alternative reference rates, clear information may be needed to be given to customers setting out the various elements making up the 'all-in' interest rate payable on the relevant product, including any credit spread adjustment. Worked examples with direct comparisons to LIBOR based rates may be particularly useful to illustrate the way in which rates would have performed over time – matters which could be illustrated include the structure of the total amount payable by customers under LIBOR and their new rates, and an indication as to which parts are variable, and which are fixed, over time.

43 FCA Q&A "Conduct risk during LIBOR transition" (November 2019)

Rate switch mechanisms

6.19 Where customers are not operationally ready to switch immediately to a new reference rate, firms may look to remediate existing legacy LIBOR contracts, and/or to prevent a build-up of new legacy LIBOR exposures, by inserting rate switching provisions that operate to replace LIBOR with a new reference rate at a set point after the date of execution.

6.20 The rate switch mechanic is also a useful tool in meeting the RFR WG target for all new and re-financed LIBOR-referencing loan products entered into after end-Q3 2020 to include clear contractual arrangements to facilitate a transfer to an alternative rate (as referred to in paragraph 4.10). Although the RFR WG specifies that such contractual arrangements can be by either pre-agreed conversion terms or an agreed process for renegotiation, it also notes that the greatest certainty for borrowers and lenders will be achieved by setting out in advance the terms for conversion at a future date (or, if that is not achievable, by aiming to come as close to this as possible to minimise the risk of protracted or unsuccessful negotiations at a later date).

6.21 How the date on which a rate switch takes place is defined or triggered will depend on the specificities of each loan: the switch to a new reference rate might not take place until LIBOR becomes unavailable or has ceased, until it has ceased to be representative, or an earlier date may be specified – including allowing for lender discretion. This is very helpful in allowing new LIBOR-linked transactions to take place before operational readiness on the part of the lender or borrower while also avoiding the increase in the stock of legacy LIBOR product that may need amending before the end of 2021. However, firms using this mechanism may want to consider how best to ensure that customers are sufficiently engaged and are making a fully informed decision about the rate that will replace LIBOR so that they understand the risks, costs and benefits of this approach and the range of alternative outcomes that may be triggered. There is a particular risk when using this approach that the customer will disengage (particularly in the current economic climate). This stems from the fact that they are entering a contract on the familiar LIBOR basis, and a rate change in a year's time may not be an immediate concern and/or they may assume that the replacement rate closely replicates LIBOR from an economic standpoint.

6.22 In communicating with clients where this type of provision is used, firms should consider how they communicate the operation of that provision effectively (e.g. whether the terms operate to switch to the new reference rate at or before LIBOR's cessation, and on what basis).[44] Firms may want to consider providing examples of how the interest rate (both the replacement benchmark itself and any credit spread adjustment methodology) would perform in a variety of potential future scenarios. Credit adjustments may need to be clearly explained, including the implications of the timing of the rate switch taking place, if a delay could result in those adjustments being, higher, lower, or the same. Although firms are not expected to manage that risk for the customer, the very fact that the banks will not be managing this risk may need to be made clear to customers.

6.23 With a rate switch mechanism, additional risks may need to be mitigated:

- where the provisions allow for a certain amount of discretion on the lender's part (whether this relates to the timing of the rate switch or to taking decisions on some of the finer detail relating to the alternative reference rate at the time the switch takes place);
- for all customers, considering the fairness of any provisions regarding the replacement of an interest rate; and
- where the customer is a consumer under the UTCCR or CRA (as applicable), ensuring that the provision is 'fair' for the customer, as is defined within these regulations.

In these circumstances, greater attention to transparency, including as to the manner in which discretions will be exercised, is necessary to mitigate potential challenges for lack of fairness.

44 FCA Q&A "Conduct risk during LIBOR transition" (November 2019)

Summary of recommendations:

- Tailor customer facing information to each customer segment.
- Engage with customers early to raise awareness and educate customers on the general implications and timing of LIBOR transition for both existing and new contracts.
- Ensure communications are presented in good time to allow customers to make informed decisions.
- Ensure information provided to customers is clear, fair and not misleading and gives an appropriate level of detail in a manner that is appropriate for that customer.
- Communicate with customers as part of a continuing information campaign to raise awareness and update customers on developments.
- Ensure application of all elements that make up the final 'all-in' interest rate is consistent and transparent. Such elements may typically comprise: a risk-free rate, a credit adjustment spread, and margin.
- Clearly communicate aspects of the alternative benchmarks where there is an element of uncertainty so that the customer can make fully informed decisions.
- Where market-wide consensus on calculation methodologies is not available, be prepared to adopt a consistent, transparent internal methodology and be able to demonstrate how the firm reached its decision that this was a fair approach.

Appropriately supporting customers

Ensuring frontline staff are sufficiently knowledgeable and supported

Pursuant to the Standards, firms should ensure that employees/agents are trained and knowledgeable about the range of products, across all channels, on offer to customers.[45]

6.24 Firms may want to provide training and a variety of training and reference resources to frontline staff to ensure compliance with this standard. Firms should consider the level of knowledge customer- facing staff need in order to understand the implications of LIBOR ending so that they can respond to customer queries appropriately. In addition to ensuring staff are fully trained on the new provisions to be included in legacy contracts and the new products available, it will be necessary to ensure they are fully aware of the alternative reference rates available and the different outcomes these options may have for customers. As part of this training, it is important that staff are able to provide objective information to customers, without providing advice (unless the terms agreed with the customer determine that the firm will advise the customer).[46] Firms may want to consider whether, following training, assessments are appropriate to evidence a sufficient level of knowledge and competence.

6.25 Given the complexity and rapidly evolving nature of the options available, firms may want to ensure that, in addition to training and internal communications, additional resources (such as FAQs and playbooks), dedicated subject matter expertise, and a clear route for escalation is available to frontline staff to support them in responding to questions from customers.

6.26 It is also important to ensure that the questions from customers, and any feedback on the information provided to them, is monitored and used to adapt and improve the information materials made available to both frontline staff and customers.

45 Paragraph 2, Standards on Product Information (Lending Standards Board Standards of Lending Practice for business customers).

46 FCA Q&A "Conduct risk during LIBOR transition" (November 2019)

6.27 Firms may want to consider the role of frontline staff. Frontline staff may be used to ensure that customers have been provided with appropriate materials and information, that the customer has the opportunity to ask questions and, ultimately, that the customer derives a sufficient level of comprehension from the materials and explanations provided. It is recommended that procedures are put in place to record the provision of information, any follow up questions and evidence a customer has understood all information provided.

6.28 Firms should be particularly aware that, when provided with a number of options, customers may look to frontline staff to take decisions for them. This is even more likely where there is an additional element of complexity or uncertainty (for example, the use of a credit spread adjustment, the use of compounded RFRs or the availability of TSRRs). Firms may want to ensure that, except where appropriate to the nature of the customer relationship and contract, frontline staff take care to avoid giving advice or recommendations, and instead focus on verifying a customer's understanding.

Summary of recommendations:

- Provide a variety of training and materials to frontline staff to ensure they are familiar with new products and rate replacement provisions and the different outcomes each alternative benchmark rate may have for customers.
- Support frontline staff in responding to customer queries with additional resources, access to dedicated subject matter expertise and a clear route for escalation.
- Use queries and customer feedback to adapt and improve the information materials made available to both frontline staff and customers.
- Put in place processes to ensure customers have understood the information provided to them.
- Ensure that frontline staff take care to avoid giving advice or recommendations.

Customers in financial difficulty

Pursuant to the Standards:

- Firms should have triggers and processes in place to help identify customers who may be in financial difficulty and should act promptly and efficiently to address the situation with the customer[47].
- Customers identified as being in financial difficulty should be contacted and provided with clear information setting out the support available to them, the next steps and, where relevant, with any action they are required to take. They should not be subject to harassment or undue pressure when discussing their financial situation[48].
- Firms should demonstrate an empathetic approach to the customer's situation; listening to and acting upon information provided by the customer with a view to developing an appropriate and mutually acceptable solution[49].
- Firms should ensure that relevant customer facing employees and relevant third parties are sufficiently trained and skilled to help them to identify and deal with those customers who may be showing signs of financial stress[50].

6.29 A firm's approach to LIBOR transition may need to include specific consideration of how to treat customers that are in financial difficulty, and those that move into financial difficulty during the transition period. In the wake of the Covid-19 pandemic, firms are likely to see a larger proportion of customers moving into financial difficulty, and, in order to ensure fair and consistent treatment of this segment of customers, firms should consider how to adapt the transition process to align with their broader approach to managing customers in financial difficulty.

6.30 In devising the transition strategy for this segment of customers, firms will need to consider how to balance the specific needs of these customers with the wider objectives and timelines for LIBOR transition in order to determine the options available to provide a fair outcome for customers. Given the particular needs of this segment of customers, it is likely that they should be prioritised for early engagement through the communications strategy.

47 Paragraph 1, Standards on Customers in Financial Difficulty
48 Paragraph 3, Standards on Customers in Financial Difficulty
49 Paragraph 4, Standards on Customers in Financial Difficulty
50 Paragraph 5, Standards on Credit Monitoring

6.31 Firms' communication strategies may need to be adapted to the individual circumstances of these customers, with clear explanations of how the actions being taken as part of transition fit with the approach being taken to manage the customer's financial situation. Options provided to address financial difficulties should not be used as a way to secure a move away from LIBOR; instead customer communications should carefully explain the different issues and provide sufficient information to allow customers to understand the options and support available to them.

6.32 Financial difficulty will be a relevant consideration in any governance process relating to legacy contract amendments or new products, so that issues arising from financial difficulty are considered and appropriate adjustments are made where necessary. This may include consideration of the target market, clarity, accessibility and the operation of the product.

6.33 Staff training will need to address the issues that may arise when managing transition for customers in financial difficulty, including signposting relevant policies and procedures to ensure a consistent approach is being taken to customer treatment.

6.34 In addition, any emergency funding situations arising as a result of the Covid-19 pandemic should not be used to force a move away from LIBOR. Instead, the risks of continuing to enter into LIBOR based lending arrangements and the relevant regulatory expectations on cessation of LIBOR might be clearly and simply explained, and customers given sufficient time to make decisions.

6.35 There is often a direct link between a business in, or at risk of, financial difficulty and the personal susceptibility of the owner to vulnerability. Therefore, firms might consider how to ensure that their approach to managing customers in financial difficulty includes consideration of how to identify vulnerable customers. This will support the ability to identify vulnerability at an early stage, and determine an appropriate strategy in response.

Summary of recommendations:

- Create a tailored strategy for the treatment of customers in financial difficulty, recognising their particular circumstances.
- If possible, identify customers that may struggle to engage with LIBOR transition as early as possible and consider prioritising communications and negotiations with these customers.
- Consider the specific requirements of customers in financial difficulty as part of the governance processes for the approach to contract amendment and new product considerations.

Customers in vulnerable circumstances

Pursuant to the Standards:

- Firms should have a vulnerability strategy, which defines its approach to the identification and treatment of individuals considered to be vulnerable, through whichever channel the customer chooses to engage[51].
- Firms' sales policies and processes should take account of the impact vulnerability may have on an individual's ability to make an informed decision about a product, and provide relevant support during the application process[52].
- The impact of an individual's vulnerability on the business customer's relationship with a firm will depend on a number of non-exhaustive factors such as: the legal structure of the business, its sophistication, the role and level of responsibility of the individual within it and the extent of the individual's vulnerability.
- Where a firm is developing a new product, or reviewing an existing product, it should consider vulnerability as part of the design or review process, paying regard to the target market, clarity, accessibility and the operation of the product.[53]
- Reference to an individual means a person who, when taking into account information available to the firm about how the business is structured and operates, is able to exert significant control over the way in which it is run.

In addition, the LSB published a report providing insight into supporting business customers in vulnerable circumstances which may provide further helpful guidance for firms.[54]

6.36 Firms' vulnerability strategies and processes may need to be adapted to address the specific challenges that LIBOR transition poses. Careful consideration may need to be given as to whether sales policies and processes for new products and legacy contract amendments need to be adjusted to address the needs of vulnerable customers, to ensure those customers are in a position to make an informed decision about amending a legacy contract or a new product.

6.37 The current economic climate may mean that LIBOR transition is not a current priority for many customers and key decision makers are likely to have their focus diverted elsewhere within the business. This may cause a delay in engagement with this customer base and exacerbate factors that give rise to heightened vulnerability. It is important to ensure that information continues to be provided to these customers as early as possible. It is recommended that, as far as possible, vulnerable customers are identified at an early stage of any LIBOR transition customer communication programme and additional support is offered if required.

6.38 Vulnerability will be a relevant consideration for any governance process relating to legacy contract amendments or new products, so that issues arising from vulnerability are considered and appropriate adjustments are made where necessary. This may include consideration of the target market, clarity, accessibility and the operation of the product.

6.39 Areas of vulnerability linked to the accessible nature of information may warrant particular care when looking at LIBOR transition due to the importance of ensuring customers can make fully informed decisions. For example, the specific requirements of customers for whom English is a second language or customers with impaired vision may need to be taken into account when producing customer-facing materials. These requirements may necessitate changes to the level/format of information provided (braille, large print), the use of shorter more illustrative examples, and clear and simple language or firms providing additional time within negotiations for customers to consider their options.

51 Paragraph 1, Standards on Customers in Vulnerable Circumstances.
52 Paragraph 7, Standards on Product Information (Lending Standards Board Standards of Lending Practice for business customers).
53 Paragraph 6, Standards on Customers in Vulnerable circumstances.
54 LSB, Supporting business customers in Vulnerable Circumstances, July 2018

Summary of recommendations:

- Identify customers that may struggle to engage with LIBOR transition as early as possible and consider prioritising communications and negotiations with these customers.
- Incorporate consideration of the specific challenges that vulnerability poses into LIBOR transition amendments to sales strategies and processes.
- Consider the specific requirements of vulnerable customers as part of governance processes for contract amendment and new products, as well as the communications strategy.

7. Transition of Existing LIBOR Contracts

7.1 In addition to the areas addressed in Section 6, this Section seeks to address a non-exhaustive list of key issues specific to the remediation of existing legacy contracts that firms may consider.

Identifying the contracts that need to be amended

7.2 Firms may want to consider undertaking a broad-ranging review exercise to identify lending arrangements that have a term (including a term that is extendable at the exclusive option of the borrower) or a commitment period that ends after 2021 and which reference LIBOR in any way.[55]

7.3 Firms can then determine whether to address the risk relating to these contracts by either amending or replacing them to:

- include robust rate switching provisions that provide certainty on the interest rate that will apply when LIBOR ceases to be published or is no longer representative; and/or
- replace LIBOR with immediate effect with an alternative reference rate.

Summary of recommendations:

- Conduct a wide ranging due diligence exercise to identify legacy contracts as early as possible to allow time for negotiation to be carried out in advance of the RFR WG timeline (of Q1 2021) after which point firms are expected to have substantially reduced their stock of legacy contracts referencing LIBOR.

Selection of alternative reference rates and conduct risk

Pursuant to the Standards:

- At the point of sale, firms should provide clear information to the customer regarding the key features of a product and any breakage or early repayment fees/costs associated with it. This information should be made available to the customer upon request, throughout the lifetime of the borrowing.[56]
- Where a customer's borrowing is linked to an interest rate benchmark and this will be transitioned to an alternative rate, firms should ensure that customers are provided with timely notification of when this change will become effective and firms should ensure that any changes to the terms of the customer's agreement are fair and transparent.[57]
- The customer should be provided with clear information regarding the reason for the changes and provided with a reasonable amount of time to seek further clarification, or where appropriate, alternative sources of finance.[58]

7.4 In choosing replacement reference rates, firms should consider the conduct-related requirements set out in Section 5 above. However, this does not mean that firms are expected to give up the difference between LIBOR and compounded SONIA (or an alternative reference rate), which results from the term credit risk premium that is built into the LIBOR rate.

7.5 Firms may look to ensure that rate switching provisions and rate setting methodologies used in connection with the transition to alternative reference rates have been reviewed and approved through an appropriate governance process to ensure that all relevant risks are taken into account including the risk of unfair outcomes for customers.

55 The same point may be made with respect to other IBORs which are changing or being discontinued, for example, Hong Kong dollar Hong Kong Interbank Offered Rate (known as HKD HIBOR), JPY Tokyo Interbank Offered Rate (known as TIBOR), and Singapore dollar Singapore Interbank Offered Rate (known as SGD SIBOR).

56 Paragraph 7, Standards on Product sake (Lending Standards Board Standards of Lending Practice for business customers).

57 Paragraph 4, Standards on Product execution (Lending Standards Board Standards of Lending Practice for business customers).

58 Paragraph 9, Standards on Product execution (Lending Standards Board Standards of Lending Practice for business customers).

7.6 Risks specific to contract remediation (and the alternative reference rates and spread adjustments therein) include:

- the risk that the contract does not perform in the way the customer has been led to expect following cessation or LIBOR being declared non-representative;
- the risk that any rate switching provisions and/or replacement rate methodology results in higher interest payments than a LIBOR contract would have done prior to cessation.

7.7 There is also the risk that early/voluntary remediation is completed using a different methodology to that subsequently recommended by industry bodies such as the RFR WG. Firms are more likely to be able to demonstrate that they have fulfilled their duty to treat customers fairly where they adopt a replacement rate (including rate switching provisions and rate setting methodology) that aligns with the established market consensus, which is reached through appropriate consultation, and is recognised by relevant national working groups as an appropriate solution.[59]

7.8 As noted at paragraph 5.4 above in respect of the FCA statement on conduct risk, firms may also need to consider whether any contract term they may rely on in a consumer contract to amend the rate applicable to a legacy LIBOR product is 'fair'.[60]

7.9 Firms should consider how to ensure that appropriate sales suitability processes are followed so that an adequate range of alternative reference rates can be offered to customers. It may be that, following this assessment, it is only appropriate for one alternative to be offered taking account of the customer needs and sophistication. Sales suitability processes will need to ensure sufficient information is provided to the customers to enable them to determine which product is most suitable for them based on assessment of the costs, risks and benefits.

7.10 When offering alternatives, it is particularly important that clear governance is established around the process by which firms engage with customers to agree appropriate rate switching provisions and alternative rate methodologies, and that adequate records of customer negotiations are maintained. Customer queries or disputes arising during the remediation process, should be used to inform the governance arrangements in place around this sale process as the transition progresses.

7.11 Please see Section 6 above for more details on information to be provided to customers. Customers may need to be made aware of the choices available, including repaying a facility or continuing with an existing contract, including the benefits and risks associated with these approaches. Where it is clear that a customer does not understand the options presented or there are concerns regarding a customer's insistence to proceed in a certain manner, additional explanations might be requested (and documented) and appropriate internal escalations undertaken.

Summary of recommendations:

- Rate switching provisions and rate setting methodologies used to transition to new alternative reference rates should be approved through appropriate governance process to ensure the specific risks for customers and the firm are considered.
- Firms should consider, where possible, adopting rate switching provisions and replacement rate methodologies that align with an established market consensus, which is reached through appropriate consultation and is recognised by relevant national working groups as an appropriate solution.
- There is a clearly defined sales suitability process in place to ensure that customers are offered an appropriate range of alternative rates to consider and are provided with adequate information in this regard.
- There is appropriate governance in place in respect of any contract negotiation with the customers, and an appropriate record of customer negotiations is made.
- Customers are aware of the range of choices available, including repaying a facility or continuing with an existing contract, including the benefits and risks associated with these approaches.

59 FCA Q&A "Conduct risk during LIBOR transition" (November 2019).
60 FCA FG18/7: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015 contains factors that firms should consider when thinking about fairness issues under the CRA when they draft and review unilateral variation terms in their consumer contracts.

Start the amendment journey with your customers

Fees for amendments and legal advice

7.12 As the circumstances of each individual borrower and their lending arrangements differ, it may not be appropriate to adopt a one-size-fits-all approach to the question of legal costs. This may remain part of the commercial negotiation with each customer on the required contractual remediation.

7.13 However, firms may want to ensure, to the extent possible, that potential legal costs for customers do not become a barrier to transition. Standardisation of methodologies, conventions, documentary provisions and continued education of, and communication with, customers may help ensure this is the case. Active demonstration of how the transition approach proposed is fair for the customer throughout all communications may help mitigate the need for significant legal engagement in many cases.

7.14 It is important, however, that firms continue to make it clear to all customers that they may wish to seek legal advice (and other professional advice) in relation to the transition and any related amendments.

Summary of recommendations:

- Firms may want to discuss legal costs with customers as early as possible as part of their communication plans.
- Firms may explore solutions that align with industry standards in order to reduce legal costs for customers.
- Firms may want to ensure, to the extent possible, that potential legal costs for customers do not become a barrier to transition.

Ensuring hedging products are managed so as to avoid basis risk

7.15 A challenge for transitioning legacy contracts arises in relation to potential mismatches in the timing and substance of the different industry recommendations to legacy transition that are being agreed at an industry group level for cash and derivative products.

7.16 Firms may want to develop a transition strategy that looks at all products a customer holds together so that, where the legacy lending arrangement and the derivative hedge have been entered into between a firm and the relevant customer, the transition of linked products can be effected at the same time (where possible). Communications should be appropriately calibrated so that the full range of customer impacts can be understood.

7.17 Firms may want to approach the amendment of legacy linked contracts with the aim of preserving the effectiveness of the hedging arrangement where possible, subject to developing market practice in derivative and loan markets.

7.18 However, it is also the case that customers may have entered into a loan with one firm and an associated hedge with another. Lending firms may wish to be mindful of this risk. It may be appropriate for lending firms to ensure that customers are aware that they need to think about the totality of their arrangements, that the lending firm may not be fully informed as to all of the customers' arrangements and that customers should proactively approach any other providers of products they hold.

Summary of recommendations:

- Firms may seek to amend legacy-linked derivative and lending arrangements in a manner that preserves their economic effect viewed as a whole.
- Firms may encourage customers to contact third-party hedging providers to ensure that suitable amendments are made to hedging arrangements in line with any amendments made to loan arrangements.

Supporting customer transition

7.19 Lenders and many customers are working hard to address dependencies that may prevent their operational and IT infrastructure from being ready to transition to new rates. Although industry wide challenges have been identified, issues in this regard are likely to be specific to each firm and customer.

7.20 Firms may want to actively manage their operational risk in this regard, including through appropriate investment in infrastructure changes and development of contingency plans that will ensure alignment with agreed industry timelines for transition and the cessation of LIBOR.

7.21 To limit the risk that customers are not operationally ready to transition firms may wish to: (a) continue to educate customers about the transition and the proposed changes so that customers can start to consider the impact on their systems, products and processes; and (b) have an active conversation with customers at the initial outreach stage to understand the degree to which system limitations could impact timing

of transition. Firms may consider using a high-level 'readiness' checklist to support customers in considering the various impacts on their business as part of their broader outreach communications strategy.

Summary of recommendations:

- Firms may want to actively manage the risk associated with changing operational and IT infrastructure to ensure they are ready for transition in line with industry timelines.
- Firms may want to proactively communicate with customers regarding their operational readiness to ensure customers are in a position to transition in line with industry timelines.

Determine if there are any contracts left which cannot be amended

7.22 On 23 June 2020, the UK Government confirmed that it intends to legislate to facilitate LIBOR transition for 'tough legacy contracts'. The Financial Services Bill laid before parliament 21 October 2020 set out how this will be achieved through amending existing UK benchmark regulations to grant the FCA additional powers. Under these powers the FCA will be able to require a change of methodology to a critical benchmark if it is deemed no longer representative. In effect, this power could be used to ensure a 'synthetic LIBOR' is available for a wind-down period, which offers a potential solution to legacy contracts that cannot be amended. The use of this power is likely to be used in parallel with a prohibition to use the synthetic benchmark in new contracts.

7.23 Even if the relevant legislation is passed, significant uncertainty remains. It is yet to be determined whether "synthetic LIBOR" will replace existing LIBOR "screen rate" contractual provisions or whether pre-existing rate switching provisions and conditions would still apply. In either case, it remains uncertain whether the FCA will utilise their powers to compel the benchmark administrator to publish a synthetic LIBOR or what the methodology for constructing a synthetic LIBOR would be. That said, the FCA has been clear that synthetic LIBOR will need to be constructed from "robust input data"[61], indicating that actual transactions and forward transactions in the derivatives market would be needed in order to construct a synthetic LIBOR. The volume and liquidity of representative derivative transactions is not known, nor is their behaviour in times of market dislocation. If it is created at all, any synthetic LIBOR may therefore be more volatile than the SONIA compounded in arrears benchmark.

7.24 The official sector and RFR WG have made clear that the prospect of legislative support should not deter firms from pursuing an active transition where viable. In addition, the instance of tough legacy contracts is likely to be limited for customers with bilateral lending products where there are clear alternatives available.

7.25 Although customers may view the prospect of a synthetic LIBOR as providing scope for arbitrage and / or as a reason to delay, firms should consider how to proactively help customers to understand the risks and surrounding reliance on any synthetic LIBOR and why active transition is therefore encouraged. An active transition provides both parties with greater certainty, as well as aligning with industry timelines and regulatory expectations. Quite apart from the uncertainty that the FCA will exercise its powers, parties relying on synthetic LIBOR will have no control over the economic terms, or the timing at which transition would occur. For reasons of legal and economic certainty, it is therefore in both lender and borrowers' interests to actively transition contracts where this is feasible.

Summary of recommendations:

- The possibility that the FCA may exercise its powers to facilitate an orderly wind down of LIBOR should not be relied on as a reason to delay proactive outreach and contractual remediation of legacy contracts.
- Customers should be informed of the limited nature of any potential relief and the risks attached to delay.

61 FCA, "Benchmarks Regulation – proposed new powers", published 23 June 2020. Available at: https://www.fca.org.uk/markets/transition-libor/benchmarks-regulation-proposed-new-powers.

8. Governance and Oversight

8.1 This Section covers governance and oversight measures that firms may wish to consider putting in place in connection with LIBOR transition. Firms are likely to have many of these measures already in place as part of their business as usual arrangements and to meet existing regulatory obligations. However, firms should consider reviewing existing practices to ensure they are sufficiently robust to manage LIBOR transition related risks.

A robust governance approach is required to support efficient LIBOR transition decision making and risk management, ensuring clear accountability that meets regulatory expectations. Firms may want to consider: whether the governance arrangements they have in place to support LIBOR transition ensure regular board and executive-level engagement to support them in discharging their responsibilities; how they can demonstrate that customers are being treated fairly; and all regulatory requirements are being met.

Pursuant to the Standards:

- Firms should have adequate governance, policies, processes, management information and controls to enable effective oversight of adherence to Standards and delivery of fair customer outcomes.[62]
- Firms should have an effective risk management framework appropriate to the size of the firm.[63]
- Firms should have systems in place to ensure that the firms' employees and agents are promoting products in a clear and transparent way.[64]
- Firms should ensure that when systems or processes are changed, or products are introduced or changed, the impact on meeting the Standards is adequately assessed.[65]
- Firms should undertake both post-launch and cyclical product reviews to ensure that their products are, and remain, fit for purpose.[66]
- Firms should have a robust complaints management process in place to deal with Standards -related complaints and to undertake root cause analysis.[67]
- Firms should assign an appropriately skilled and senior individual(s) with clear accountability for overseeing that customer outcomes are achieved, and for ensuring that remedial action is instigated where this is not happening.[68]

Governance

8.2 The FCA has stated that Boards and senior management at firms are expected to understand the risks associated with LIBOR transition and take appropriate action to move to alternative rates ahead of the end of 2021.[69] The FCA goes on to note that: "For many, LIBOR transition will impact their overall business strategy and front-office client engagement, rather than being a narrow legal and compliance risk. Potential impact and risk therefore need to be considered and addressed in an appropriately coordinated way across a firm."[70]

8.3 It is important for firms to consider how to embed accountability for management and oversight of the LIBOR transition as part of existing governance structures and processes, with clearly defined roles and responsibilities for individuals and relevant committees, confirming which committees have responsibility for managing and overseeing LIBOR transition, including decision-making authority. It is useful to document these responsibilities in the relevant committee terms of reference.

62 Paragraph 1, Standards on Governance and Oversight (Lending Standards Board Standards of Lending Practice for business customers).
63 Paragraph 2, Standards on Governance and Oversight (Lending Standards Board Standards of Lending Practice for business customers).
64 Paragraph 4, Standards on Governance and Oversight (Lending Standards Board Standards of Lending Practice for business customers).
65 Paragraph 6, Standards on Governance and Oversight (Lending Standards Board Standards of Lending Practice for business customers).
66 Paragraph 9, Standards on Governance and Oversight (Lending Standards Board Standards of Lending Practice for business customers).
67 Paragraph 11, Standards on Governance and Oversight (Lending Standards Board Standards of Lending Practice for business customers).
68 Paragraph 12, Standards on Governance and Oversight (Lending Standards Board Standards of Lending Practice for business customers).
69 Governance and Accountability, Conduct Risk During LIBOR Transition Q/A (FCA) 19 November 2019.
70 Governance and Accountability, Conduct Risk During LIBOR Transition Q/A (FCA) 19 November 2019.

8.4 In view of the regulatory requirement to act with due skill, care and diligence, firms might review whether the individuals involved in the management and oversight of LIBOR transition have the appropriate knowledge and expertise required and put in place training and support as necessary.

8.5 It is important to keep clear records of discussions held and decisions made, including the rationale for the decision taken and the information on which it was based.

Reporting

8.6 Firms will want to consider how to include reporting on issues specific to LIBOR transition into regular reporting and management information (MI), for discussion at relevant governance committees, up to and including the Board. The key components of the reporting might include project key performance indicators, risk MI, and results of assurance work. Reporting could also include feedback from customer engagement as well as complaints data to support early identification of issues that may require further attention. Ensuring that the senior manager with responsibility for transition is provided with adequate reporting will help to support effective discharge of his/her regulatory responsibilities.

Individual Accountability

8.7 Where appropriate, regulators expect firms to identify the senior manager responsible for overseeing transition away from LIBOR and for those firms subject to the Senior Managers and Certification Regime to include this in their Statement of Responsibilities. It is likely that there will be other senior managers with responsibility for delivery of particular aspects of the transition given their existing business area or control function responsibilities. Firms may wish to ensure that the roles and responsibilities of individuals are clearly defined, understood and documented, with clear delineation between each senior manager's responsibilities.

Risk management

8.8 There is a regulatory expectation that firms have robust risk management processes in place to identify and manage the financial and non-financial risks associated with LIBOR transition.[71] It is helpful to clearly define the roles of first line business, second line control functions and third line internal audit functions in managing the risks associated with LIBOR transition.

8.9 Firms may find it helpful to carry out a firm-wide risk assessment to identify the key risks associated with the transition programme, including all outsourcing partners and third party providers involved in the provision of products and services to customers and legacy LIBOR contract remediation. Firms will need to consider the impact of LIBOR transition across all principal risk types and ensure that the existing risk taxonomy allows for identification and management of all relevant risks arising. Given regulatory focus, firms may wish to consider whether additional risk management arrangements need to be put in place for certain non-financial risks such as conduct.[72] Specific conduct risks relating to selecting an appropriate replacement rate are considered in Sections 5 and 7.

8.10 Having assessed the risks identified for probability and impact, firms must ensure that a plan is in place to manage these risks, through adequate processes, controls, monitoring and reporting across the business. Firms may want to review the risk assessment regularly throughout the transition period to ensure new risks are identified and managed. Best practice indicates that any changes in risk profile throughout the transition period are reported through risk governance, as well as to the accountable senior manager and periodically to the Board.

Customer Treatment

8.11 Firms should ensure that their approach to transition is designed in a way that delivers fair treatment of customers, as outlined in paragraphs 6.3 to 6.23 and 6.29 et seq. (Customers in financial difficulty). Particular attention may need to be paid to the needs of vulnerable customers and those in financial difficulty. This includes ensuring that throughout each stage of the customer journey, from initial engagement, product development and sale to post-sale communications, firms can demonstrate that customers are being treated fairly.

8.12 Throughout the transition period, firms should pay particular consideration to the complaints and query handling policies and procedures firms have in place within client-facing functions. Alternative escalation channels may also be made available to customers where a complaint concerns the conduct of a sales representative. Firms may want to put in place a process by which complaints and queries can be collated, analysed and reported on a regular basis to help inform the LIBOR programme on an ongoing basis and identify any emerging issues at an early stage.

71 Governance and Accountability, Conduct Risk During LIBOR Transition Q/A (FCA) 19 November 2019.

72 Governance and Accountability, Conduct Risk During LIBOR Transition Q/A (FCA) 19 November 2019.

In view of the conduct risks identified within the risk assessment and the need to ensure customers are being treated fairly, firms might find it helpful to consider how they will monitor the effectiveness of customer engagement throughout the product lifecycle, including the complaints process.

Product Governance

8.13 Firms might consider whether they adapt their existing product governance processes to ensure that material LIBOR-related product changes are captured, or create new processes through new LIBOR governance arrangements. Regardless of the method chosen for the process, firms will want to adequately consider the needs of their customers and the suitability of products, and have controls in place to ensure that any conflicts of interest are being managed effectively. This includes affording additional considerations for those customers in financial difficulty, as well as vulnerable customers, as outlined in paragraphs 6.29 et seq. (Customers in financial difficulty) and 6.36 et seq. (Customers in vulnerable circumstances).

Assurance

8.14 In addition to regular management oversight, firms may wish to consider how they will build LIBOR transition into independent oversight and assurance activities to ensure that the transition programme is being delivered as planned. This might include reviews by business risk or compliance monitoring teams, as well as reviews by the Internal Audit function or external parties. Firms might additionally look to include coverage of the quality control, testing and assurance activities undertaken within the regular reporting and MI.

Summary of recommendations:

- Identify the Senior Manager responsible for oversight of LIBOR transition and update Statement of Responsibilities accordingly.
- Determine which committees have responsibility for managing and overseeing LIBOR transition and ensure terms of reference reflect this.
- Provide training to individuals involved in the management and oversight of LIBOR transition to ensure they have the appropriate knowledge and expertise required.
- Produce regular reporting and management information for discussion at relevant governance committees, and ensure processes are in place to keep records of key decisions made.
- Identify the risks arising from transition and determine how these will be managed, through adequate processes, controls, monitoring and reporting across the business.
- Review the end-to-end customer journey, from initial engagement to post-sale communications, to ensure fair customer treatment.

9. Conclusion

There are a significant number of challenges facing firms as they seek to safely and effectively transition customers to non-LIBOR linked products before the end of 2021. While it is clear that there is a high level of awareness of these issues with substantial activity underway across the industry, sustained efforts are required to deliver this fundamental change to current practice by the deadlines set.

One of the foremost issues is the selection of alternative reference rates to be used in contracts with customers. When deciding on which of these alternative reference rates to offer to SME customers, firms will need to carefully assess the practical implications of each, while taking account of each customer's individual circumstances.

A further key issue for firms is ensuring that customers are suitably informed of the costs, risks and benefits of alternative reference rates. Firms need to ensure that the information is delivered in a way that enables the customer to make an informed choice. This is key to achieving good customer outcomes, whether making changes to an existing contract or entering into a new contract.

There is a wide range of risks arising from LIBOR transition that could result in poor customer treatment, and firms will need to ensure that all necessary measures are taken to manage these effectively. In particular, the Covid-19 pandemic has posed a range of challenges for small and medium-sized enterprises across the UK, and underlines the need for firms to make appropriate arrangements to support vulnerable customers and those in financial difficulty throughout the LIBOR transition process. The recommendations set out in this paper are aimed at helping firms facilitate good customer outcomes, as well as ensuring consistency across the industry, where appropriate: the recommendations made are summarised in Annex 3.

As the industry approach to LIBOR transition continues to evolve, it is likely that there will be further developments in market practices and regulatory expectations in the coming months. Firms should take all necessary steps to keep up to date with regulatory and industry developments throughout the transition period and continue to consider the implications of these for their ongoing activities to achieve a successful transition away from LIBOR.

Annex 1:

Glossary

ARRC	Alternative Reference Rates Committee: the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York convened the ARRC in 2014 to develop best practice recommendations in identifying potential alternative reference rates for USD LIBOR and for ensuring contract robustness in transactions relying on LIBOR, and also to create an implementation plan to support the voluntary adoption of its recommended rate. The ARRC is comprised of a diverse set of private-sector entities as members, including buy-side, sell-side, end users, trade associations, and intermediary market participants. The ARRC is also comprised of a wide array of official-sector entities, including banking and financial sector regulators, as ex-officio members
Bank Rate (Base Rate)	The interest rate paid by the BoE to commercial banks that hold money with the BoE
BoE	Bank of England
CHF	Swiss Francs
Code	Invoice Finance and Asset Based Lending Code: the Code sets the commitments that UK Finance IFABL members must meet when providing the following products and associated services: factoring, invoice discounting and asset based lending
CRA	Consumer Rights Act 2015
EUR	Euros
EURIBOR	Euro Interbank Offered Rate
FCA	Financial Conduct Authority
GBP	Pounds sterling (British pounds)
IBOR	Interbank Offered Rate
IFABL	Invoice Finance and Asset Based Lending
IOSCO	International Organization of Securities Commissions
JPY	Japanese yen
LIBOR	London Interbank Offered Rate
LSB	Lending Standards Board
MI	Management information
PRA	Prudential Regulation Authority
RFR	Risk-free (or nearly-risk free) reference rate
RFR WG	Working Group on Sterling Risk-Free Reference Rates: a working group initiated by the BoE in 2015 in response to the Financial Stability Board's 2014 recommendation for the development and adoption of RFRs as alternatives to existing IBOR benchmarks. Membership of the RFR WG is drawn from a diverse set of market participants representing relevant sectors and markets, including (among others) banks/broker dealers; asset management firms, pension funds and insurance companies; corporates and other issuers; infrastructure firms; and trade associations
SMCR	Senior Managers and Certification Regime: an individual accountability framework for senior management and other staff as implemented by the FCA and the PRA
SME	Small and medium-sized enterprises
SOFR	Secured Overnight Financing Rate

SONIA	Sterling Overnight Index Average
SONIA compounded in arrears	The interest rate produced by compounding the daily SONIA rate over an interest period (or an observation period if the observation shift methodology is used) to produce a backward-looking rate for that period.
Standards	Standards of Lending Practice for business customers, March 2017 (as updated in August 2020): a voluntary set of standards which set the benchmark for good lending practice in the UK, outlining the way registered firms (a list of which is available at https://www.lendingstandardsboard.org.uk/registered-firms/ are expected to deal with their businesses customers with a turnover of up to £25m throughout the entire product life cycle. They became a 'recognised industry code' by the FCA on 11 February 2020 and are overseen by the LSB. A copy of the Standards is available at: https://www.lendingstandardsboard.org.uk/wp-content/uploads/2020/08/Standards-of-Lending-Practice-for-business-customers-August-2020-Covid-update.pdf
Statement of Responsibilities	A document in a form prescribed by the FCA and the PRA setting out the roles and responsibilities of the individuals within all senior management functions as required by the SMCR
synthetic LIBOR	A LIBOR rate produced (after LIBOR in its current form ceases to be representative) on the basis of a changed methodology using suitable alternative robust data inputs
TLT	The RFR WG's Tough Legacy Taskforce
tough legacy contracts	Contracts that genuinely have no or inappropriate alternatives to LIBOR and no realistic ability to be renegotiated or amended
TSRR	Term SONIA Reference Rate
USD	United States dollars
Use Cases Paper	"Use Cases of Benchmark Rates: Compounded in adus, Term Rate and Further Alternatives" published by WG RFR in January 2020, which can be found at: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/use-cases-of-benchmark-rates-compounded-in-arrears-term-rate-and-further-alternatives.pdf
UTCCR	Unfair Terms in Consumer Contracts Regulations 1999

Annex 2:

Treating Customers Fairly Outcomes

Outcomes firms should strive for to ensure TCF compliance during LIBOR transition:

FCA TCF Outcomes	Reference within this Guidance
Consumers can be confident they are dealing with firms where the fair treatment of customers is central to the corporate culture	
Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly	Sections 5 and 6 (paragraphs 5.8 to 6.16 and 6.14 to 6.23), 7 (paragraphs 7.4 to 7.11), and 8.
Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale	Section 6, 7 (paragraphs 7.12 to 7.21) and 8.
Where consumers receive advice, the advice is suitable and takes account of their circumstances	Section 6
Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect	Section 6 and 8.
Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint	Section 8

Annex 3:

Summary Recommendations

Alternative Reference Rates	
Tailor customer facing information to each customer segment.	
Engage with customers early to raise awareness and educate clients on the general implications and timing of LIBOR transition for both existing and new contracts.	
Ensure communications are presented in good time to allow customers to make informed decisions.	
Ensure information provided to customers are clear, fair and not misleading and give an appropriate level of detail in a manner that is appropriate for that customer.	
Communicate with customers as part of a continuing information campaign to raise awareness and update customers on developments.	
Ensure application of all elements that make up the final 'all-in' interest rate is consistent and transparent.	
Clearly communicate aspects of the alternative benchmarks where there is an element of uncertainty so that the customer can make fully informed decisions.	
Where market wide consensus on calculation methodologies is not available, be prepared to adopt a consistent, transparent internal methodology and be able to demonstrate how the firm reached its decision that this was a fair approach.	
Ensuring frontline staff are sufficiently knowledgeable and supported	
Provide a variety of training and materials to frontline staff to ensure they are familiar with new products and the different outcomes each alternative risk-free rate may have for customers.	
Support frontline staff in responding to customer queries with additional resources, access to dedicated subject matter expertise and a clear route for escalation.	
Use queries and customer feedback to adapt and improve the information materials made available to both frontline staff and customers.	
Put in place processes to ensure customers have understood the information provided to them.	
Ensure that frontline staff take care to avoid giving advice or recommendations.	
Customers in financial difficulty	
Create a tailored strategy for the treatment of customers in financial difficulty	
If possible, identify customers that may struggle to engage with LIBOR transition as early as possible and consider prioritising communications and negotiations with these customers.	
Consider the specific requirements of customers in financial difficulty as part of the governance processes for contract amendment and new product considerations.	

Summary of recommendations	Status
Customers in vulnerable circumstances	
Identify customers that may struggle to engage with LIBOR transition as early as possible and consider prioritising communications and negotiations with these customers.	
Incorporate consideration of the specific challenges that vulnerability poses into LIBOR transition amendments to sales strategies and processes.	
Consider the specific requirements of vulnerable customers as part of governance processes for contract amendment and new products, as well as the communications strategy.	
Identifying contracts that need to be amended	
Firms may conduct a wide ranging due diligence exercise to identify legacy contracts as early as possible to allow time for negotiation to be carried out in advance of the industry agreed timeline (of Q1 2021) after which point firms are expected to have substantially reduced their stock of legacy contracts referencing LIBOR	
Choosing appropriate alternative reference rates	
Assessment of fair replacement rates may be made on the information available at the relevant time	
Language used to transition to new alternative reference rates is approved through appropriate governance process to ensure the specific risks for customers and the firm are considered	
There is a clearly defined sales suitability process in place to ensure that customers are offered an appropriate range of alternative rates to consider and provided with adequate information	
There is a process in place to agree points of negotiation with the customer, and to record the outcomes	
Fees for amendments and legal advice	
Ensure that legal costs are discussed with customers as early as possible as part of their communication plans	
Explore solutions that align with industry standards in order to reduce legal costs for customers	
Ensure to the extent possible that potential legal costs for customers do not become a barrier to transition	
Ensuring hedging products are managed so as to avoid basis risk	
Seek to amend legacy linked derivative and lending arrangements in a manner that preserves their economic effect viewed as a whole	
Supporting customer transition	
Actively managing the risk associated with changing operational and IT infrastructure to ensure they are ready for transition in line with industry timelines	
Proactively communicate with clients regarding their operational readiness to ensure customers are in a position to transition in line with industry timelines	
Tough legacy contracts and the role of legislation	
Tough legacy legislative solutions may not be relied on as a reason to delay proactive outreach and contractual remediation of legacy contracts	
Customers may be informed of the limited nature of any potential relief and the risks attached to delay	

Summary of recommendations	Status
Governance and oversight	
Identify the Senior Manager responsible for oversight of LIBOR transition and update Statement of Responsibilities accordingly	
Determine which committees have responsibility for managing and overseeing LIBOR transition and ensure terms of reference reflect this	
Provide training to individuals involved in the management and oversight of LIBOR transition to ensure they have the appropriate knowledge and expertise required	
Produce regular reporting and management information for discussion at relevant governance committees, and ensure processes in place to keep records of key decisions made	
Identify the risks arising from transition and determine how these will be managed, through adequate processes, controls, monitoring and reporting across the business	
Review the end-to-end customer journey, from initial engagement to post-sale communications, to ensure fair customer treatment	

With thanks

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Kate Sumpter
Partner, A&O

John Budd
Associate, A&O

Jack Prettejohn
Associate, A&O

Kelly Shutt
Professional Support Lawyer, A&O

Tom Lodder
Managing Director, A&O Consulting

Claire Haydon
Executive Director, A&O Consulting

Olivia Kendall-Martin
Senior Consultant, A&O Consulting

A&O has been leading the charge on analysing and addressing the impact of the discontinuation of LIBOR for well over a year and has been at the forefront of transition efforts in the financial services sector, globally. As a firm they have built-up a huge body of expertise in this area within their dedicated cross-practice, multi-disciplinary, international team working full-time on IBOR transition and its related issues.

As well as working hand-in-hand with clients on full transition projects, A&O has also developed IBOR Toolkit – a collection of integrated, practical resources and materials, available "off-the-shelf" to help clients develop and execute IBOR transition strategies in a cost effective way. For more information on A&O's capabilities and experience in relation to IBOR transition, or more generally across the financial services sector, please get in touch with the authors or visit www.AllenOvery.com