



NEWSFLASH

## Recommendations for a smooth transition to risk-free rates: LuxCMA view

**Luxembourg, 13 July 2021**

### **LuxCMA recommendations for a smooth transition to risk-free rates**

LuxCMA herewith invites the different stakeholders across the securities value chain, from issuers to investors, to consider taking the necessary actions in order to ensure, where appropriate, a smooth transition to Alternative Reference Rates (ARR) / Risk-Free Rates (RFR) in replacement of Interbank Offered Rates (IBOR), in both their existing and future securities issuance legal documentation.

The announced discontinuation date for London Inter-bank Offered Rates (LIBOR) at the end of 2021 (with some exceptions for USD LIBOR) indeed leaves the market with less than 12 months to adapt.

### **Background**

For more than 40 years, IBORs have been a fact of daily life for the global financial services industry. A series of scandals has sealed the fate of the once dominant IBOR benchmarks. In 2012, a group of banks were accused of manipulating their IBOR submissions during the financial crisis. In the wake of those scandals, the EU Benchmarks Regulation (Regulation (EU) 2016/1011) was introduced in 2016 and implemented in January 2018. The act regulates the provision of, the contribution to, and the use of benchmarks. Various working groups have been setup to select Alternative Reference Rates (ARR) / Risk-Free Rates (RFR) to replace IBORs:

- The LIBOR is planned to be replaced by the Sterling Over Night Index Average (SONIA) for GBP, the Secured Overnight Financing Rate (SOFR) for USD, the Euro Short Term Rate (€STR) for EUR, the Swiss Average Rate Over Night (SARON) for CHF and the Tokyo Over Night Average Rate (TONAR) for JPY.

- The Euro Interbank Offered Rate (EURIBOR) is expected to transition into €STR.
- Other IBORs may also be reformed or replaced in the future.

In terms of volumes of outstanding legacy bonds, at the end of 2020, there were more than 4,300 Eurobonds with a maturity beyond 2021 referencing LIBOR as the benchmark rate. Any modification to the method of calculating interest payable on securities constitute a fundamental economic and commercial change to the securities. Legal, logistical and practical challenges may arise as a result.

## Challenges

The IBOR transition will demand a significant transformational effort from both financial services firms and market participants with extensive exposure, bringing a number of challenges along the way, namely:

- Orderly transition of the market to risk free rates remains a challenge to the industry.
- Potential market disruption in light of the number of outstanding securities possibly impacted as they reference IBOR benchmarks, in particular asset-backed securities, floating-rate notes and senior bonds as well as regulatory capital securities issued by financial institutions.
- New securities issued without fallback provisions or with only temporary fallback provisions (not suited to address permanent discontinuation).
- Operational lag with execution risks (avoid overload in late 2021).
- Impact on income processing flows (change in rate fixing timing & methodology) and timeline for consent solicitation.
- Program documentation: inclusion of appropriate language is needed.
- Risks and costs of late modifications to the securities' Terms & Conditions (T&Cs).

## Recommendations

To ensure a smooth IBOR transition, LuxCMA recommends to its members and any participants in the debt capital markets industry to take the following actions as soon as possible:

- Prepare an overview of outstanding securities impacted by the transition.
- Consult a legal advisor to determine and implement the most appropriate transition path (e.g. benchmark replacement, fallback provision inclusion, early redemption).
- Inform clients & counterparties (e.g. trustees, SWAP counterparties) about the upcoming operational and legal changes.

- For the newly issued securities, apply the ARR/RFR or include a fallback provision; consider the agreed standard language for securitisation contracts; assess a modification mechanism for EMTN and covered bonds segments in case of reference rate discontinuation without the need for bondholder's consent.
- For the existing securities maturing after 31 December 2021, amend T&Cs with/without bondholder's consent/meeting or proceed with a written resolution if allowed under T&Cs; plan the bondholder's consent solicitation event sufficiently ahead as the process might be time-consuming depending on the options requested by issuers and consent's terms dictated by various governing laws.
- Leverage the annual review of the program documentation.
- Disseminate the updated program and issuance documentation to investors, agents and infrastructures as soon as available.

## Further information

- 🔗 ECB, Information on interest rate benchmarks  
[https://www.ecb.europa.eu/paym/interest\\_rate\\_benchmarks/html/index.en.html](https://www.ecb.europa.eu/paym/interest_rate_benchmarks/html/index.en.html)
- 🔗 ICMA, Guide to the transition to risk-free-rates  
[A-quick-guide-to-the-transition-to-risk-free-rates-in-the-international-bond-market-February-2020-27022020.pdf](https://www.icmagroup.org/~/media/2020/02/27/2020-02-27-ICMA-Guide-to-the-transition-to-risk-free-rates-in-the-international-bond-market-February-2020-27022020.pdf) (icmagroup.org)
- 🔗 ICMSA Bulletins
  - 200120/47 - Benchmark replacement and fallback provisions  
[ICMSA Bulletin 200120/47 - Benchmark replacement and fallback provisions - ICMSA - International Capital Market Services Association](https://www.icmsa.com/~/media/2020/12/20/200120-47-ICMSA-Bulletin-Benchmark-replacement-and-fallback-provisions-ICMSA-International-Capital-Market-Services-Association.pdf)
  - 200305/49 - The discontinuation of LIBOR/IBORS – different approaches for transition under English law trust deeds and New York law indentures  
[ICMSA Bulletin 200305/49 - The discontinuation of LIBOR/IBORS - different approaches for transition under English law trust deeds and New York law indentures - ICMSA - International Capital Market Services Association](https://www.icmsa.com/~/media/2020/05/20/200305-49-ICMSA-Bulletin-The-discontinuation-of-LIBOR-IBORS-different-approaches-for-transition-under-English-law-trust-deeds-and-New-York-law-indentures-ICMSA-International-Capital-Market-Services-Association.pdf)
  - 200610/50 - The discontinuation of LIBOR/IBORS – timeline of a consent solicitation  
[ICMSA Bulletin 200610/50 – The discontinuation of LIBOR/IBORS - timeline of a consent solicitation - ICMSA - International Capital Market Services Association](https://www.icmsa.com/~/media/2020/10/20/200610-50-ICMSA-Bulletin-The-discontinuation-of-LIBOR-IBORS-timeline-of-a-consent-solicitation-ICMSA-International-Capital-Market-Services-Association.pdf)

- 210118/54 - The discontinuation of LIBOR/IBORS – implications for English-law note trustees and agency roles – Update – Legacy Transactions  
[ICMSA Bulletin 210118/54 - The discontinuation of LIBOR/IBORS – implications for English-law note trustees and agency roles – Update – Legacy Transactions - ICMSA - International Capital Market Services Association](#)
- 210118/55 - The discontinuation of LIBOR/IBORS – operational and procedural considerations for Consent Solicitations and Written Resolutions  
[ICMSA Bulletin 210118/55 – The discontinuation of LIBOR/IBORS – operational and procedural considerations for Consent Solicitations and Written Resolutions - ICMSA - International Capital Market Services Association](#)

🔗 ICSDs' recommendation paper for a smooth transition  
[ibor-recomendation-data.pdf \(clearstream.com\)](#)

All those who would like to become a LuxCMA member should visit [www.luxcma.com](http://www.luxcma.com) or contact [info@luxcma.lu](mailto:info@luxcma.lu).

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## ABOUT LUXCMA

The Luxembourg Capital Markets Association (LuxCMA) represents the common interest of all stakeholders of the primary capital markets industry of Luxembourg. Its mission is to promote Luxembourg's capital markets, provide networking and collaboration opportunities and foster innovation in the industry. LuxCMA's is to become the single point of contact for authorities, associations, market practitioners and other actors.

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