



Fallbacks for LIBOR floating rate notes

By Catherine Wade

Traditional fallback provisions (Type 1)¹

RFR Floating rate notes (FRNs) issued prior to Andrew Bailey's July 2017 speech² typically include "traditional" fallback provisions which, in summary, provide that if the relevant reference rate is not available at the relevant time, then the party responsible for determining the rate (usually an agent of the issuer) must request quotes from a certain number of major banks in the interbank market (known as "reference banks") and use the quotes provided to determine a rate. If the agent cannot obtain a certain number (or any) quotes from reference banks, then the rate will be the rate in effect for the last preceding interest period.

It is unlikely that, in the event of a permanent cessation of LIBOR, reference banks would provide quotes for any length of time if at all. Therefore, absent any other intervention³, the majority of legacy FRNs that reference LIBOR and contain traditional fallback provisions will become fixed rate instruments in the event of a permanent cessation of LIBOR, because the rate in effect for the last preceding interest period will be applied to every interest period for the remaining life of the note.

Alternative fallback provisions (Type 2)

After Andrew Bailey's July 2017 speech, issuers of FRNs began to consider "alternative" fallback provisions to

supplement the "traditional" fallback provisions described above.

In Europe and Asia, market practice has evolved since July 2017 to a point where alternative fallbacks are now common in new issues of long-dated FRNs and updated or newly established multi-currency debt issuance programmes that envisage the issuance of long-dated FRNs.

Alternative fallbacks typically seen in new European FRNs and multi-currency debt issuance programmes are designed to apply across currencies and in respect of different benchmarks (not just LIBOR and/or other IBORs) and do not refer to specific alternative rates such as the relevant risk-free reference rate (RFR) or term RFR to address the permanent discontinuation of a rate or benchmark

Rather than referring to specific alternative RFRs or term RFRs, alternative fallbacks in European documentation typically envisage (broadly) the issuer appointing an independent adviser to select (or to advise the issuer in the selection of)⁴ an alternative or replacement rate and adjustment spread to be applied to such rate, in each case, on the basis of (a) any recommendations made by relevant official bodies (see below) or (b) if no such recommendations have been made, customary market practice⁵.

1. References to Type 1, 2 and 3 fallbacks are for convenience only. This categorisation is not referred to in the contractual documentation and there may be overlap between each "Type" of fallback, which varies in detail from issuer to issuer.

2. Andrew Bailey, Chief Executive of the FCA: *The Future of LIBOR*, 27 July 2017.

3. See also: Paul Richards, *The Transition to Risk-Free Rates in the Bond Market*, ICMA Quarterly Report Third Quarter 2019.

4. There is a degree of variation in the fallback language and in particular regarding whether the issuer makes the determination of the replacement rate (having been advised by the independent adviser) or the independent adviser makes the determination. This may depend upon the nature of the issuer, for example it might be more appropriate for financial institution issuers to make the determination, whereas it might be less so for a corporate issuer.

5. The alternative fallbacks contained in some regulatory capital securities are stated to be subject to compliance with any regulatory requirements.

Relevant official bodies are likely to include:

- the relevant central bank or supervisory authority; and
- any working group or committee sponsored by, chaired or co-chaired by or constituted at the request of the relevant central bank or supervisory authority or group of central banks or supervisory authorities or the Financial Stability Board.

In the case of the European securitisation market, AFME has developed [model interest rate modification language](#) to provide for certain changes to be made to terms and conditions via a simplified consent mechanism with the involvement of the trustee.

To date such a mechanism has not been seen in the vanilla FRN markets, where a trustee may not be a feature of many transactions.

Latest fallback provisions (Type 3)

Subsequent statements and publications in 2018/19, which include:

- a speech on [LIBOR Transition and Contractual Fallbacks](#) by Edwin Schooling-Latter of the FCA on 28 January 2019;
- the European Central Bank's Working Group on euro area risk-free rates [Guiding Principles for Fallback Provisions](#) in January 2019; and
- publication by the Alternative Reference Rate Committee in the US of its [Guiding Principles for Fallback Contract Language](#) in July 2018, its [consultation](#) and [Recommended Fallback Language for Floating Rate Notes](#) published on 25 April 2019

have provided the market with some guidance or recommendations on appropriate fallback drafting principles relevant to certain currencies.

For certain issuers these statements and publications have further influenced the drafting of the currency and benchmark agnostic fallback language included in multi-currency debt issuance programmes which have been updated with new fallbacks in 2019⁶. Any new fallback language, as updated, will apply to new issuance of FRNs only⁷.

In some cases, new fallbacks have started to include the concept of a pre-cessation trigger based upon a statement of "unrepresentativeness" of the relevant original benchmark by the regulator of the administrator of the benchmark.

It is worth noting that practice in the European and Asian FRN markets continues to vary depending on the nature of the issuer and their longer-term issuance plans.

The language recommended by the US Alternative Reference Rates Committee (ARRC) is applicable only to new US dollar-denominated FRNs and so varies in a number of important ways to the currency and benchmark agnostic language that is being used typically in the European FRN market. For example, the ARRC drafting hardwires different forms of SOFR as the replacement rate. The language also includes some optionality for users. These are recommendations only, encouraged for use by ARRC for new contracts and the related guide acknowledges that variations will be appropriate.

Current European practice for contractual fallback language for programmes aligns with the ARRC language in many areas, but differs in others and therefore whilst the same outcome would be likely from an application of this Type 3 fallback language (because the provisions operate to follow any recommendation or market practice in relation to the original benchmark), you could not guarantee an identical outcome to what might result from applying the ARRC language. An important distinction is that for example the typical language followed in Europe tends to envisage (broadly) the issuer appointing an independent adviser to select (or to advise the issuer in the selection of) an alternative or replacement rate and adjustment spread. This is not a feature of the ARRC language.

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6. Financial institutions issuers have tended to be the most reactive in updating fallback language to reflect latest developments. Many, particularly smaller, corporate issues have not updated their fallback language from Type 1 as they may not envisage issuing long dated FRNs imminently.

7. Amending the fallback language in programme documentation does not retrospectively change the fallback language in relation to any notes already in issue. These will form part of the legacy notes which will need to transition in accordance with their own terms and conditions.