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FINMA Guidance 10/2020: LIBOR transition roadmap

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Overview

On 4 December 2020, the Swiss Financial Market Supervisory Authority (FINMA) published a transition roadmap for LIBOR (FINMA Guidance 10/2020).

The purpose of FINMA Guidance 10/2020 is to clarify FINMA's recommendations to the affected supervised institutions and market participants and to ensure that they use the remaining time until the end of 2021 to prepare for a discontinuation of LIBOR in CHF, EUR, GBP and JPY (in all tenors), and in USD (in the 1W and 2M tenors) across all product types.

FINMA still considers the end of LIBOR as one of the principal operational risks facing its supervised institutions and recommends that the affected institutions adhere to the transition roadmap described below in order to be fully prepared for a discontinuation of LIBOR in CHF, EUR, GBP and JPY, as well as USD by end-2021.

Transition roadmap

By 25 January 2021:

- Signing of the protocol released by the International Swaps and Derivatives Association (ISDA), the IDSA 2020 IBOR Fallbacks Protocol: The affected supervised institutions should have signed the ISDA 2020 IBOR Fallbacks Protocol. Further recommendations on LIBOR replacement for derivatives can be found in FINMA's Guidance 08/2020.

By 31 January 2021:

- No new "tough legacy": By 31 January 2021, no new transactions based on CHF or EUR LIBOR maturing after the end of 2021 and not providing for robust fallback clauses should be concluded. The same objective should also be pursued for GBP, JPY or USD LIBOR-based new transactions.
- Readiness to lend based on ARR: Lenders should be ready to grant loans which are not based on CHF, EUR, GBP, JPY or USD LIBOR. Borrowers should be given the possibility

Pestalozzi Rechtsanwälte AG
Feldeggstrasse 4
CH-8008 Zürich
T +41 44 217 91 11
zrh@pestalozzilaw.com

Pestalozzi Avocats SA
Cours de Rive 13
CH-1204 Genève
T +41 22 999 96 00
gva@pestalozzilaw.com

pestalozzilaw.com

to choose another rate (fixed interest and/or an alternative reference rate (ARR) such as the Swiss Average Rate Overnight (SARON)).

By 31 March 2021:

- Plans for the reduction of "tough legacy": Based on a complete assessment of their inventory of existing CHF and EUR LIBOR contracts, the affected supervised institutions should have identified which contracts and which contract volume are potentially "tough legacy" as they are due after 2021 and do not yet include robust fallback clauses. Detailed project plans and a progress monitoring procedure should be put in place in order to reduce the stock of "tough legacy" contracts to a minimum volume by the end of 2021.To achieve this, FINMA recommends establishing at least one first contact with the counterparties of potential "tough legacy" contracts by 31 March 2021 at the latest, in order to start the renegotiation process. This applies to all product types, i.e. not only loans and derivatives. For the remaining tenors of LIBOR in GBP, JPY and USD, FINMA suggests that the affected supervised institutions negotiate a conversion to ARR-based contracts with their counterparties.

By 30 June 2021:

- System and process changes implemented: The affected supervisors should have made the necessary system and process changes to ensure that they are replaced by ARR and that fallback rates are applied.
- Mitigation of risks for remaining "tough legacy": By implementing the plans set out above, the affected institutions should be in a position to assess whether the objective of reducing the volume of "tough legacy" contracts is achievable. For all contracts for which no solution is apparent, a risk assessment should be made and specific precautions should be taken to minimise these risks.
- New contracts in general based on ARR: In general, the affected supervised institutions should only use ARR in new CHF, EUR, GBP, JPY and USD contracts.

By 31 December 2021:

- Full operational readiness: All relevant systems and processes should be able to function without dependence on LIBOR.
- All new contracts based on ARR: All new transactions with variable interest in CHF, EUR, GBP, JPY and USD should be based on ARR.

FINMA supervisory plan for 2021

FINMA will continue to closely monitor the development of the contract volume linked to LIBOR in 2021 and collect information on the development of existing and new LIBOR-based engagements as well as on the handling of "tough legacy" contracts. Where necessary, FINMA will implement institution-specific measures in order to limit the risks of inadequate preparation for the replacement of LIBOR.

Next steps/need for action

The time to act is now. We recommend the affected supervised institutions to fully adhere to FINMA's transition roadmap in order to make the LIBOR transition process as smooth as possible.

Contributor: Daniela Fritsch (Associate)

No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this Legal Update.

Andrea Huber

Partner
Attorney at law, LL.M.

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 41
andrea.huber@pestalozzilaw.com

Oliver Widmer

Partner
Attorney at law
Head Financial Services

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 42
oliver.widmer@pestalozzilaw.com