# BULLETIN – 210510/56

# ICMSA Bulletin – The role of Calculation Agents and Benchmark Agents/Independent Advisors

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In the context of the discontinuation of LIBOR and other relevant benchmarks during and after 2021 and the inclusion in international debt capital markets' instruments of drafting to cater for such discontinuation in transactions, it is important to understand the differing roles of the various agents involved in the process. This paper sets out an overview of the role of the Calculation Agent (both on a typical MTN issuance and on a swap transaction) and the role of the Benchmark Agent/Independent Advisor as commonly included in benchmark replacement wording or alternative fallback language in a MTN issuance.

There are various agent roles on a MTN issuance; (i) Paying Agents, which are responsible for certain administrative matters in respect of the notes, including paying sums due with a Principal Paying Agent usually taking responsibility for receiving interest and principal proceeds from the Issuer and ensuring that funds are distributed to the relevant noteholders; (ii) Registrars and Transfer Agents which are required in registered MTN issuances and responsible for maintaining the register for registered notes and recording any transfers; (iii) Calculation Agents which, as set out more fully below, assist the Issuer on interest calculations on floating rate MTNs; and (iv) Benchmark Agents/Independent Advisors which, as also set out more fully below, assist the Issuer in determining a new benchmark upon discontinuation of an existing benchmark as set out in specific discontinuation provisions.

**Role of the Calculation Agent on a typical MTN issuance versus the role of the Calculation Agent on a swap transaction**

On a typical MTN issuance, the Calculation Agent (or, in some cases, the Principal Paying Agent) is responsible for determining the rate of interest and interest amounts per note for each relevant interest period. The Calculation Agent role has both a data collection and mathematical calculation element – it collects figures from the appropriate source (eg a screen page) and then uses such figures for the relevant calculations. It will often be the same entity that is the Principal Paying Agent and may also hold other agency roles on the transaction.

For floating rate MTNs, the rate of interest is usually set by reference to either an ISDA determination method or a screen rate determination method.

For floating rate MTNs using an ISDA determination method, provisions typically provide that the rate of interest is determined by reference to the relevant ISDA Rate plus or minus (as applicable) the margin (as specified in the applicable final terms). The ISDA Rate is defined as the rate equal to the Floating Rate as would be determined by the Calculation Agent under an interest rate swap transaction under the terms of an agreement incorporating the 2006 ISDA Definitions (or, in some cases, the 2000 ISDA Definitions or other earlier ISDA Definitions), with the applicable final terms on an ISDA determination MTN specifying what the Floating Rate Option is and therefore where the Calculation Agent should collect the various rates from eg EURIBOR – Reference Banks (with reference banks providing the applicable figures), EURIBOR - Bloomberg (with the Bloomberg screen page providing the applicable figures), GBP-LIBOR- Reference Banks (with reference banks providing the applicable figures) or GBP-LIBOR-BBA (with the Reuters screen page providing the applicable figures). Depending on the Floating Rate Option selected, the 2006 ISDA Definitions (for transactions entered into before 25 January 2021) prescribe various fallbacks if the relevant screen page is unavailable or an insufficient number of reference banks provide the relevant rate; generally, if the relevant screen page is unavailable, then the fallback is to reference banks and, if fewer than two reference banks provide the relevant rate, then the rate is determined as an arithmetic mean of rates quoted by major banks in the designated zone as selected by the Calculation Agent at a specified time and for a specified period (as set out in the applicable final terms). However, there are certain notable exceptions for specific rates where a fallback to a determination by the Calculation Agent is included; for instance (as an example) where GBP-ISDA-Swap Rate is specified, if the relevant rate is unavailable on the applicable screen page, then the determination falls back to the Calculation Agent (rather than to reference banks). In addition, for certain of the reference bank rates (eg Israeli Shekel-TELBOR-Reference Banks), where fewer than a specified number of banks and/or dealers provide quotations as requested then the rate is determined by the Calculation Agent.

As a response to the upcoming discontinuation of LIBOR and other relevant benchmarks, ISDA launched the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol in October 2020. This is in addition to the 2018 Benchmarks Supplement which is discussed further below. The IBOR Fallbacks Supplement amends the 2006 ISDA Definitions in order to incorporate further fallback provisions for certain IBORs and came into effect on 25 January 2021. As such, any transaction (including a floating rate MTN) entered into on or after 25 January 2021 that incorporates the ISDA 2006 Definitions will include the amendments set out in the IBOR Fallbacks Supplement. Transactions entered into before 25 January 2021 that incorporate the ISDA 2006 Definitions (or other prior ISDA Definitions) will not be amended by the IBOR Fallbacks Supplement and will continue to be governed by the ISDA 2006 Definitions (or other prior ISDA Definitions) without reference to the IBOR Fallbacks Supplement. The IBOR Fallbacks Protocol enables parties to a broad range of transactions that were entered into prior to 25 January 2021 to adhere to the IBOR Fallbacks Supplement and thereby incorporate the additional fallback amendments into the ISDA 2006 Definitions (or other prior ISDA Definitions). Adherence to the IBOR Fallbacks Protocol is voluntary, requires the relevant parties to confirm adherence for the IBOR Fallbacks Protocol to apply (it will not automatically apply to transactions entered into before 25 January 2021) and, crucially, does not apply to note issuances including floating rate MTNs.

The IBOR Fallbacks Supplement includes new fallbacks in the event of a permanent cessation of relevant IBORs and, for LIBOR specifically, in the event of a pre-cessation event (a notification from the relevant regulator confirming, amongst other things, that the rate is no longer representative). Generally, in the event of a permanent cessation of a relevant IBOR or, in the case of LIBOR, non-representativeness, the IBOR Fallbacks Supplement provides for an alternative risk free rate to apply (and also contains further fallbacks if such alternative risk free rate is unavailable) without any fallback to a determination by the Calculation Agent. If the specified IBOR is unavailable but a permanent cessation has not occurred then, generally, the IBOR Fallbacks Supplement provides that the rate will be the rate formally recommended for use by the administrator of the relevant IBOR or, if that rate isn't available, the rate formally recommended for use by the supervisor responsible for supervising the relevant IBOR or the administrator of the relevant IBOR. If neither of these rates are available then the IBOR Fallbacks Supplement generally provides that the Calculation Agent shall determine a commercially reasonable alternative for the relevant IBOR, taking into account any rate implemented by central counterparties and/or futures exchanges, in each case with trading volumes in derivatives or futures referencing the relevant IBOR that the Calculation Agent considers sufficient for that rate to be a representative alternative rate.

For floating rate MTNs using a screen rate determination method, the rate of interest is determined by the Calculation Agent by reference to the offered quotation for the relevant reference rate appearing on the relevant screen page at the applicable determination time (all as further specified in the applicable final terms). If the relevant screen page is unavailable, the provisions would typically oblige the Issuer to approach a certain number of reference banks to provide the Calculation Agent with their offered quotation for the relevant reference rate for the purposes of the Calculation Agent's determination of the rate of interest. In the case where no such offered quotations are provided and/or available (and in the case where there is no benchmark replacement wording or alternative fallback language (as discussed further below)), some transactions provide for the rate of interest to fallback to the last determined rate of interest – thus (potentially) turning a floating rate MTN into a fixed rate MTN.

With a few limited exceptions, it can be seen that the role of a Calculation Agent on a floating rate MTN is purely administrative, applying set criteria and a specific fallback cascade to determine the interest rate for the relevant interest period, and then using a formula to calculate the amounts of interest payable. It is essentially a non-discretionary, non-commercial role, and one in which the Calculation Agent is not "setting the terms of a financial instrument" and therefore not regarded as a "user" for the purposes of the Benchmark Regulations. This is supported by the contractual appointment terms of a Calculation Agent for floating rate MTN issuances which confirm the non-commercial nature of the role (in contrast the appointment terms of a Calculation Agent under a swap). Calculation Agents on a floating rate MTN that includes an ISDA determination will need to be alert to the inclusion of rates where the applicable ISDA Definitions (and any related amendments) (as discussed above) contain a fallback to a Calculation Agent determination as this imposes a commercial decision on the Calculation Agent. It should be expected that Calculation Agents would seek to include drafting in the Calculation Agent provisions in floating rate MTNs to amend the position under the applicable ISDA Definitions to avoid any requirement for the Calculation Agent to make a commercial determination as the ultimate fallback. It should also be noted that the mechanics for the calculation of alternative risk free rates are different from the mechanics for IBOR calculations – alternative risk free rates are for the most part overnight, backward looking rates and certain observation and calculation times are included in the IBOR Fallbacks Supplement. Calculation Agents on a floating rate MTN with an ISDA determination entered into on or after 25 January 2021 will want to ensure that there are no operational issues with the observation and calculation timings prescribed under the IBOR Fallbacks Supplement and may seek to amend such requirements under the relevant MTN documentation, if required.

In contrast, the role of the Calculation Agent on a swap transaction is often performed by one of the commercial parties to the transaction and, as such, the Calculation Agent generally has a greater level of discretion and commerciality than would typically be relevant for a Calculation Agent on a MTN issuance i.e. going beyond simply data collection and mathematical calculations. For instance, the Calculation Agent on a swap transaction would typically liaise with the reference banks directly to obtain offered quotations and may have discretion to select banks or dealers for the purposes of making any calculation or determination or to select any exchange rate. Under the 2006 ISDA Definitions, the Calculation Agent is required to make such determinations in good faith and in a commercially reasonable manner and to consult the other parties. In light of the upcoming discontinuation of LIBOR and other related benchmarks and, in advance of the IBOR Fallbacks Supplement being issued, ISDA released a 2018 Benchmarks Supplement which prescribes the fallback position which would apply if a reference rate or benchmark ceases or is prohibited from use. The 2018 Benchmarks Supplement sets out various fallbacks including (i) agreement between the relevant swap parties; (ii) use of a replacement benchmark nominated at the time of trading plus an adjustment payment; (iii) use of a substantially equivalent replacement benchmark nominated by the administrator or relevant nominating body; or (iv) use of a replacement benchmark nominated by the Calculation Agent plus an adjustment spread. The parties are required to act in good faith and use commercially reasonable efforts to apply the fallbacks within a specified period of time. In addition, the 2018 Benchmarks Supplement provides a hierarchy if more than one of the fallbacks is available and covers the situations where there is a dispute in respect of a determination on the fallbacks.

The 2018 Benchmarks Supplement covers a broader range of benchmarks than the IBOR Fallbacks Supplement which deals with certain IBORs. For the purposes of transactions where the 2018 Benchmarks Supplement applies (as discussed further below) and the IBOR Fallbacks Supplement applies, the IBOR Fallbacks Supplement will take precedence for the relevant IBORs.

As noted above, on a swap transaction, the Calculation Agent is typically one of the commercial parties and therefore has a much greater level of discretion – this is evident in the IBOR Fallbacks Supplement and also evident in the 2018 Benchmarks Supplement which includes a Calculation Agent Nominated Replacement Index being an index, benchmark or other price source that the Calculation Agent determines to be a commercially reasonable alternative for the Relevant Benchmark. However, unlike the IBOR Fallbacks Supplement, the 2018 Benchmark Supplement fallback position is not automatically incorporated into the 2006 ISDA Definitions (or other applicable ISDA Definitions) and therefore, unless the drafting specifically confirms that the 2018 Benchmarks Supplement applies, this fallback position on an ISDA determination MTN would not be applicable. It would be highly unusual for a Calculation Agent on a MTN to be given the express power to use its discretion to determine an alternative benchmark and accordingly MTN issuances with an ISDA determination do not normally incorporate the 2018 Benchmarks Supplement.

**Role of the Benchmark Agent/Independent Advisor**

Across many MTN issuances, market participants have since mid-2017 developed and incorporated into new deal terms benchmark replacement wording or alternative fallback language. This enables an Issuer to replace LIBOR (or any other relevant benchmark) following the occurrence of a “Benchmark Event” – broadly, a situation where a benchmark rate is not available or ceases to exist, or a public announcement is made with respect to the proposed discontinuation or loss of representativeness of such benchmark. The provision typically includes the appointment of an Independent Advisor or a Benchmark Agent to assist the Issuer in determining the appropriate successor or alternative rate, any adjustment to the margin or inclusion of any adjustment spread, and any other required amendments to the documents to reflect the use of the successor or alternative rate or the adjusted margin. It is a situation specific appointment with clearly defined responsibilities.

The Independent Advisor or Benchmark Agent is typically required to be an independent financial institution of international repute or an independent financial advisor with appropriate expertise in the international debt capital markets and appointed by the Issuer (at the Issuer’s expense). It is not expected that either the Calculation Agent or Principal Paying Agent would take on such role. The extent of the Independent Advisor’s or Benchmark Agent’s involvement varies across transactions. In some cases, it is the Issuer who determines the appropriate successor or alternative rate, the adjustment spread and any further required amendments, but the Issuer would have an obligation to consult with the Independent Advisor or Benchmark Agent. In other cases, the Issuer has an obligation to use reasonable endeavours to appoint an Independent Advisor or a Benchmark Agent, and it is then the Independent Advisor or Benchmark Agent that determines the appropriate successor or alternative rate, adjustment spread and any further required amendments. There would typically be a fallback that if, despite using its reasonable endeavours, the Issuer is unable to appoint an Independent Advisor or a

Benchmark Agent (or the Independent Advisor or Benchmark Agent is unable to make such determination), the Issuer is able to determine the appropriate successor or alternative rate, adjustment spread and any further required amendments itself (and, in the absence of such a fallback provision, if the Issuer is unable to appoint an Independent Advisor or Benchmark Agent, it would not be possible to adopt a successor or alternative rate without noteholder consent).

In the cases where an Independent Advisor or a Benchmark Agent is appointed to make the relevant determinations on behalf of an Issuer, these determinations would typically involve:

a) a determination of a successor rate – a successor rate is usually defined as a successor to, or replacement of, the original reference rate as formally recommended by a relevant nominating body (a relevant nominating body in such a situation would typically be the central bank or supervisory authority for the currency to which the original reference rate relates or any working group or committee sponsored or requested by such central bank or supervisory authority);

b) if no successor rate is available, a determination of an alternative rate. This is typically defined as an alternative benchmark or screen rate that has replaced the original reference rate in customary market usage, or is otherwise an industry-accepted rate in the international debt capital markets, for the purposes of determining rates of interests for a commensurate interest period and in the same specified currency as the relevant notes;

c) a determination of the adjustment spread, which aims to reduce or eliminate, to the extent reasonably practicable in the circumstances, any economic prejudice or benefit to noteholders as a result of the replacement of the original reference rate with a successor rate or alternative rate. The adjustment spread typically has to be formally recommended or customarily applied in the international debt capital markets; and

d) a determination of any required amendments to the documents necessary to follow market practice or to ensure the proper operation of any successor rate, alternative rate or adjustment spread (including, for example, amendments to the definitions of the day count fraction, business day or relevant screen page).

Following the determination of a successor rate, alternative rate, adjustment spread or any benchmark amendments, the Issuer is required to notify the Calculation Agent, Principal Paying Agent or any other party responsible for determining the rate of interest for a particular issuance of these determinations promptly or within a sufficient time frame to enable the Calculation Agent to update its systems in order to carry out the new calculation (and for the clearing systems' records to be updated).

As a matter of practice, in advance of making its formal "determination" as described in the above paragraphs (but specifically paragraph (d) above), the Independent Advisor or Benchmark Agent should consult with the Calculation Agent and Principal Paying Agent to ensure that the proposed methodology and timings are workable in practice and accepted since they will be the parties required to make the necessary calculations and payments.

Again a sharp contrast can be drawn between the administrative non-discretionary role of a Calculation Agent on a floating rate MTN and a Benchmark Agent/Independent Advisor appointed specifically in connection with benchmark discontinuation. The latter having a substantial discretionary and advisory responsibility with a high degree of commerciality.

## Mismatch between a note fallback position and a corresponding swap fallback position

It should be noted that there is potential for there to be a mismatch between the fallback position for a MTN issuance and the fallback position for any corresponding or linked swaps for such MTN issuance (eg where an Independent Advisor/Benchmark Agent determined a different fallback position on a MTN issuance to the Calculation Agent's determination of the fallback position on a corresponding or linked swap that incorporated the 2018 Benchmarks Supplement). Primarily, this would be a concern for Issuers given the potential impact on their funding arrangements. However, the risk of such mismatch has been around for a number of years and is not solely relevant in the context of the discontinuation of LIBOR and other related benchmarks; on MTN issuances the drafting of the standard screen rate determination fallback and ISDA determination fallback which would apply to the corresponding or linked swap (in each case, prior to the inclusion of specific benchmark replacement wording or alternative fallback language for the MTN issuance or the incorporation of the 2018 Benchmarks Supplement on the corresponding or linked swap) do not align as the screen rate determination fallback would require reverting to the last obtained rate (and thus potentially turning a floating rate note into a fixed rate note). This would not apply on an ISDA determination as the 2006 ISDA Definitions fallback (both pre and post application of the IBOR Fallbacks Supplement) does not provide for a fallback to the last obtained rate. Nevertheless, care must be taken to avoid potential mismatch between floating rate MTNs and related swap transactions as a consequence of LIBOR transition, whether by reason of differing fallback cascades or the absence of effective fallbacks or the adherence to the IBOR Fallbacks Protocol or the 2018 Benchmarks Supplement.

## Conclusion

It is important to understand the differences between the various roles involved with interest rate calculation and any fallback position and, in particular, to note the distinction between roles that are expected to take commercial decisions as to alternative benchmarks (Calculation Agents on swap transactions and Independent Advisors/Benchmark Agents) and those that assist with the administrative aspects (data collection and mathematical calculations) of interest rate calculations (Calculation Agents on MTN issuances). In addition, Issuers and other transaction parties should be aware of the different fallback positions and take a holistic approach to the fallback operation to ensure that the impact of any mismatch between MTNs and any corresponding or linked swaps has been fully considered.