Loan Market Association
the authoritative voice of the EMEA market

LIBOR and Alternative Benchmarks

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Transition to a world without LIBOR

- On 27 July 2017, Andrew Bailey, Chief Executive of the Financial Conduct Authority (**FCA**), gave a speech highlighting:

  - **Limitations to LIBOR reform**

  - **The way forward**

- In November 2017, the FCA confirmed that LIBOR panel banks have agreed to continue submitting to LIBOR until end-2021

- On 12 July 2018, Andrew Bailey gave a further speech highlighting why firms need to end their reliance on LIBOR by the end of 2021, why RFRs are the right foundation for interest rate markets, and the progress made on transition to RFRs and the work that remains to be done

- On 19 September 2018, the FCA and PRA wrote jointly to the CEOs of major banks and insurers supervised in the UK to request details of the steps they have undertaken to manage the transition from LIBOR to alternative interest rates

LIBOR alternatives – Risk Free Rates (RFRs)

Jurisdiction	Working Group	Alternative RFR	Rate administration	Characteristics		
				Secured vs. unsecured	Anticipated publication date / time	Description
UK	Working Group on Sterling Risk- Free Reference Rates	Reformed Sterling Overnight Index Average (SONIA)	Bank of England	Unsecured	09:00 GMT *T+1*	• Fully transaction-based • Encompasses a robust underlying market • Overnight, nearly risk-free reference rate • Includes an expanded scope of transactions to incorporate overnight unsecured transactions negotiated bilaterally and those arranged with brokers • Includes a volume-weighted trimmed mean
US	Alternative Reference Rates Committee	Secured Overnight Financing Rate (SOFR)	Federal Reserve Bank of New York	Secured	Published since 3 April 2018 08:00 ET *T+1*	• Fully transaction-based • Encompasses a robust underlying market • Overnight, nearly risk-free reference rate that correlates closely with other money market rates • Covers multiple repo market segments, allowing for future market evolution
Europe	Working Group on Risk-Free Reference Rates for the Euro Area	Euro Short-Term Rate (ESTER)	European Central Bank	Unsecured	By October 2019 09:00 CET *T+1*	• Fully transaction-based • Reflects the wholesale euro unsecured overnight borrowing costs of euro area banks
Switzerland	The National Working Group on CHF Reference Rates	Swiss Average Rate Overnight (SARON)	SIX Swiss Exchange	Secured	Currently being published 12:00, 16:00 and 18:00 CET *same day*	• Became the reference interbank overnight repo on 25 August 2009 • Secured rate that reflects interest paid on interbank overnight repo
Japan	Study Group on Risk-Free Reference Rates	Tokyo Overnight Average Rate (TONA)	Bank of Japan	Unsecured	Currently being published 10:00 JST *T+1*	• Fully transaction-based benchmark for the robust uncollateralized overnight call rate market • The Bank of Japan calculates and publishes the rate on a daily basis, using information provided by money market brokers known as Tanshi • As an average, weighted by the volume of transactions corresponding to the rate

Sterling RFR developments

- Working group conducted term rate consultation in 2018
  - found the development of a robust forward-looking term rate could help facilitate transition in certain segments of the cash market
  - use of OIS swap quotes, a blend of futures and OIS swaps data
  - interested benchmark administrators were required to respond by 15 February (NB: ICE Term RFR Portal)
- Sub-group on syndicated loans
  - chaired by the LMA
  - work has included: identifying transition issues, options for referencing SONIA, fallbacks to SONIA, how to transition legacy documents
  - Revised replacement of screen rate clause (May and October 2018)
- Paper on conventions for referencing SONIA in cash products
- Thinking on cash market adjustment spreads following ISDA consultation
- Infrastructure sub-group and forum looking at systems issues

The ARRC consultation for US$ syndicated loans

- What are the four components of LIBOR fallback language for syndicated loans?
  - **Trigger** – What event precipitates a transition from LIBOR to the new reference rate?
    - Mandatory Triggers
      - ISDA Triggers
      - Pre-cessation Triggers
    - Opt-in Triggers
      - Could reduce the inventory of loans that would have to be transitioned upon LIBOR cessation, thus reducing systemic risk
  - **Replacement Reference Rate** – What is the new reference rate for the loan?
  - **Spread Adjustment** – Because LIBOR and the replacement rate (likely SOFR) are different rates, there may need to be a spread adjustment to make them more comparable. What is the mechanism to determine that rate?
  - **Amendment Process** – Some variants of fallback language require amendments

- What are the ARRC's two proposals for syndicated loan fallbacks?
  - An "**Amendment**" approach that is similar to the fallback language that has been introduced in syndicated loan agreements over the past 12+ months.
  - A "**Hardwired**" approach that anticipates the transition from LIBOR and sets all the terms for that transition at the origination of the credit agreement (thus avoiding the need for an amendment in most cases). Closely aligned with the proposed fallback language for floating rate notes (and other cash products).

There are pros and cons to each approach

Amendment Approach	Hardwired Approach
Terms are not predetermined so may require many loans to be amended in short amount of time	Avoids amendments (in most cases)
Does not rely on terms that do not currently exist (Term SOFR, Compounded SOFR)	Predetermined terms means giving up flexibility
Opportunity for winners and losers	Less susceptible to gamesmanship
Similar to what the loan market has already developed / is familiar with	Inclusion will be a bigger change to current practice
Leverages loans' unique amendment flexibility	More closely aligned with other cash products

LIBOR and the LMA documents

- Changes were made to the interest rate fallback provisions in LMA documentation in November 2014 following reforms to LIBOR
  - the disappearance of LIBOR for “less common” currencies and tenors caused unexpected difficulties

- There are now two alternative optional fallback provisions:
  - option 1 which provides for additional fallbacks to shortened interest periods and/or historic interest rates
  - option 2 which provides for a shorter waterfall, but which was redrafted from the pre-2014 fallbacks

- The LMA also introduced “domestic interest rate benchmark schedules” for non-LIBOR currencies
  - language included in LMA facility agreements to allow use of a “Benchmark Rate” for a “Non-LIBOR Currency” and to add details of appropriate market conventions by way of a schedule for each Non-LIBOR Currency

The LMA approach – Replacement of Screen Rate clause

– The LMA published a rider on 25 May 2018 with a revised version of the Replacement of Screen Rate clause (now publicly available on the Bank of England website, but applies across currencies)

– Facilitates further flexibility than the existing clause
  - permits amendments with a lower consent threshold than may otherwise be required in a wider range of circumstances

– Allows amendments to be made to facilitate inclusion of a replacement benchmark which:
  - is formally selected as a replacement for LIBOR by the LIBOR administrator or by an appropriate regulator; or
  - is otherwise accepted by the relevant markets; or
  - is deemed appropriate by the requisite majority of lenders and the obligors

– The clause can either apply at any time or upon a “Screen Rate Replacement Event”

– The clause was agreed with the ACT and borrower representatives

Euro RFR developments

- ESTER due to be published by October 2019 at the latest
- Request to European legislative authorities to extend BMR transitional period
  - political agreement reached on this
- Discussion paper on transition from EONIA to ESTER published in December 2018
  - feedback in favour of recalibrated EONIA published until end of 2021
- Consultation paper on determining an ESTER-based term structure methodology as a fallback in EURIBOR-linked contracts published in December 2018
  - feedback in favour of a forward-looking term rate based on tradable OIS quotes
- EURIBOR to be moved to hybrid methodology, for which BMR approval being sought
- Guiding principles on fallbacks for cash products published in January 2019
- LMA sits on Euro RFR WG and various sub-groups

The LMA’s transition work

- The LMA remains active in discussions with regulators and national working groups, to ensure that the interests of the loan market are represented
- In particular, the LMA is a member of: Sterling, euro and Swiss Franc working groups (including chairing the Sub-group on benchmark transition issues in syndicated loan markets and representation on the Sterling RFR Working Group)
- Given the importance of a consistent approach being adopted across the financial markets, the LMA is also continuing its coordination with other relevant trade associations in the global financial markets (including: the ACT, AFME, APLMA, FIA, GFMA, ICMA, ICMSA, IA, ISDA, JBA, JSLA, LSTA (which is a member of the US working group), SIFMA, UK Finance)
- Minutes of the monthly meetings that take place between these association on LIBOR transition are now available on the LMA LIBOR Microsite (and websites of other trade associations)

Issues for the market – New deals

- Currently replacement forward-looking term rates based off RFRs are not available for any currency – and work is progressing at different paces across the different currencies

- Use of compounded overnight rates require significant system changes, which are likely to take considerable time to develop, test and adopt

- The market will need to work out how to price transactions off RFR based benchmarks that do not include the ‘bank credit element’ that LIBOR does, and are likely not to reflect market volatility in the way that LIBOR does

- Fallbacks need to be included in new documents that contemplate and accommodate permanent cessation of LIBOR – including an ‘adjustment spread’ to ensure, to the extent possible, the economics of the transaction remain the same for both lenders & borrowers

Issues for the market – Legacy deals

- Depending on when it was drafted, and to what extent it followed LMA language, documentation may not contemplate permanent cessation of a benchmark (e.g. LIBOR/EURIBOR)

- An ‘adjustment spread’ will need to be agreed to ensure, to the extent possible, value is not transferred as between the lenders & borrowers – discussions are taking place in various working groups about the adjustment spread issue

- There is no mechanic (akin to the ISDA protocol) for amending deals en masse. Therefore loan documents need to be amended on a deal by deal basis – a huge logistical task

- The LMA is looking at ways to at least partially streamline this process

So – What should you be doing?

- Tracking the latest developments via trade association and regulator websites. The LMA LIBOR Microsite collects all LIBOR related information in one convenient place

- Responding to consultations to make sure the views of the loan market are made clear

- Engaging with your banks to explain your needs & make sure they are aware of what is happening

- Do not ignore this as ‘not a 2019 issue’. LIBOR really could disappear, and 2021 is not far away!

Market practice and guidelines

- The LMA continues to keep the market informed of developments and, in September 2018, the LMA and ACT released a second edition of the joint guide entitled “**The future of LIBOR: what you need to know**”
- The guide provides an overview of developments and key issues
- A third edition of the guide will be published later this spring which will cover the most recent developments