LIBOR transition is here – Borrowers at the ready

The 'final countdown' for LIBOR is here. We are now in the third month of 2021 and LIBOR transition deadlines are fast becoming a stark reality. The regulatory message remains clear: LIBOR transition is happening, the focus must be on active transition and this is the year when loan market participants must be ready to lend and borrow based on risk-free rates. The continued publication of key USD LIBOR tenors until June 2023 does not change this.

The transition from LIBOR to risk-free rates affects everyone in the syndicated loan market. We previously conducted an interview on the agency approach to LIBOR transition. In this interview, we shine a spotlight on the approach of borrowers to the transition, including the impact that Covid-19 has had on transition efforts.

Kam Mahil, Senior Director – Legal at the LMA spoke to David Plimmer, Assistant Group Treasurer at National Express Group plc about his views on the borrower approach to LIBOR transition.

David, thank you very much for agreeing to share your views and experiences on this important topic.

No problem at all – good to catch up again after a very strange few months!

You were the first mover in the loan market with your bilateral SONIA facility back in July 2019. Did you draw on the SONIA facility and how did you find the process?

Yes, in co-operation with one of our relationship banks (NatWest) we entered into a bilateral facility, which we did draw on many times as part of our day to day funding requirement – so it served a purpose from a practical sense as well as being a great opportunity to better understand SONIA and the mechanics of risk free rates.

The overriding benefit was that 'toe in the water' aspect where we could discover how the calculations work and discuss any limitations or discrepancies in a real life scenario – without the pressure of this being on our core RCF. Therefore we found the initial documentation relatively quick to agree, and following that it was a two way learning exercise, with some productive discussions around calculations, rounding and conventions etc. One constraint was not having system capability, but the exercise to develop a spreadsheet tool (while not a long term solution) helped our understanding all the more.

Last year we saw the publication of recommended conventions for loans in various currencies, including sterling and US dollars. Given the approach adopted on your bilateral facility, how have you viewed the development in the conventions?

The process was beneficial for both sides and thankfully the market seems to be settling on many of the methodologies we agreed in the bilateral – so we are in a good place to apply this to the wider facilities. We used the five day lag, cumulative compounding method, and while proposed alternatives such as the observation shift were looked into at the time, we feel comfortable with how things have settled and the consistency between sterling and USD. There of course will be differences between the bilateral and what we finally agree on our RCF, but we knew that would be the case and we can build on the knowledge and experience gained over the past 18 months.

The published conventions reference the use of a daily non-cumulative compounded rate (NCCR), and the LMA documentation sets out the underlying formulae for calculation absent reconciliation tools. There are those who say that the NCCR is too difficult, which is reminiscent of the conversations we had about backward-looking compounded rates this time last year at the LMA evening seminar. How are you finding the process of getting up to speed with the new conventions and how would you view the concerns of "it's all too difficult"?

I have to say that while it's important to get this right, and we are an example of a team who have tried to take something of a pro-active role in LIBOR transition, it is a challenge to keep up with some of the changes and more technical elements – especially with a global pandemic taking up so much of our attention. I imagine this is a view held by many after the past 12 months.

Debates and guidance around observation shift v five day lag, and cumulative v non-cumulative rates are certainly important and shouldn't be simply dismissed as too difficult given their impact on documentation, calculations and systems. However any uncertainty on which convention will prevail can easily lead many, who are stretched in terms of workload, to take a 'wait and see' approach until things become more established. Now is certainly the time to get up to speed though as these conventions are set to soon become a part of daily treasury life.

National Express also has a syndicated RCF and other bilateral facilities to be transitioned. You recently had your annual review with your relationship banks. Did LIBOR transition form part of the annual review and how did you find the responses compared to the last annual review?

Yes we discussed LIBOR transition with each bank, which meant many discussions in a short space of time, but like last year it helped us to gauge readiness on both sides and plan for the year ahead. Last year there was a noticeable difference across the group, and I guess that was somewhat understandable given the work still being done to agree conventions and with limited corporate activity.

This year, given the upcoming deadlines for new facilities, the gap is thankfully far narrower and while there are still some aspects to be fully agreed upon, all of our banks are in good shape to work with us. We expected this but it was nice to be reassured!

It's been a rather busy time for corporates with the impact of Covid and Brexit to contend with. How has Covid impacted your LIBOR transition plans and how are you viewing your transition plans this year?

It's no surprise that 2020 turned our workload upside down and we had to react quickly and on many fronts to help steer the company through the Covid crisis – with Brexit thankfully having less of an impact. We nevertheless kept up to date with LIBOR developments so our early efforts were not wasted, and ensured we kept our divisions and other departments aware of the changes still coming our way. It's fair to say Covid reaction did take priority, but with the regulatory bodies and system providers still working on this over 2020 we still feel in good shape for 2021 - and not hugely behind where we would have been.

This year we remain very busy with the impact of Covid, but our LIBOR transition plan is a key priority that is now in motion. The initial focus is on amending our core loan facilities over the next few months, well ahead of the end of year deadline but with enough time to discuss and understand areas of flexibility or commercial impact.

Given the differing timelines between jurisdictions, how is that impacting your approach to your multicurrency facilities?

It's a question that came up on our recent discussions with banks. Having a multicurrency facility gives us flexibility and we ideally would not want LIBOR reform to restrict this. Given the way the jurisdictions are moving at different paces it feels that we may need to stagger the changes or at least treat each currency as a separate exercise. This may actually help as we can, for example, prioritise GBP which is our main currency, align USD if the methodology settles on the same basis, and defer EUR to a later date.

Systems readiness is always a hot topic when it comes to LIBOR transition. You mentioned that you did not have systems in place for the bilateral SONIA facility. Do you now have systems in place to cater for risk-free rates?

The bilateral was indeed managed via a spreadsheet which as I mentioned did help our understanding, but we certainly do not want that to be the case going forwards. At the moment we are working on system updates and ensuring that we engage with our provider as we look to agree facility amendments. We have seen progress on this front but it is still a work in progress from both sides.

Has systems readiness (either on your side or the lender side) had an impact in terms of discussions on whether to move to a day one risk-free rate facility or whether you opt for a rate switch facility?

Recently yes, as we can see benefits from both approaches – with day one being a quicker and potentially neater solution, avoiding credit adjustment spreads for example and more generally enabling us to move on past this. However there is a balancing act I feel between managing the discussions with banks and lawyers around documentation, internal resources, and of course systems. We need to have our system set up and ready to go at the point we start utilising our facilities, with the built-in methodology ensuring we reconcile to the penny every time. That may be more manageable with a switch date, as it gives us a bit more flexibility to ensure the system is ready after the documentation is finalised, rather than all at once.

When it comes to LIBOR transition and corporates, it's not all about loans. LIBOR transition can impact corporates in other ways. How are you dealing with the process of the impact on trade and supply chain finance facilities, intercompany loans and other commercial contracts?

For us, loan facilities are the primary focus - we do not have any floating rate derivatives in place beyond the end of 2021 – so we are lucky in that we do not have any transition issues on that side.

However we do have a number of trade finance and supply chain facilities that reference LIBOR and use term rates for discounting, so this is another area where we need to work closely with our banks over the next few months. While we understand that term rates will not be available for our loans, we do need a clear and sensible solution for these other calculations and it's been pleasing to see some progress on this with SONIA term rates being published for example. Our approach here is aligned to the loan project where we can focus on GBP/USD and then EUR as and when required.

We do also have a number of intercompany loans with interest linked to LIBOR and there is a separate project to transition these. Given the additional documentation and systems impact, simplicity is the main aim with one option being a relevant base rate plus margin for example. We are working with our divisions, finance and tax colleagues to ensure any replacement works for all.

Finally on commercial and non-treasury agreements there is the important task of keeping all relevant teams updated and aware of the changes coming. This transition can impact many areas of the business that are beyond the scope and visibility of the treasury team, so we are communicating with our divisions, legal, property and procurement teams for example. They can then either come to us, or seek their own advice on the best course of action depending on materiality and potential impact.

From your perspective, is there anything else that you think is needed to support LIBOR transition for corporates?

It feels that there is growing clarity on where the market is settling, and banks are certainly in good shape now to assist on a more detailed level – I think there has been plenty of general advice, presentations and webinars etc, so now it feels that corporates understand what's going on, but maybe need more tailored advice. I certainly think any reports to confirm all impacted facilities and trades across a business and its divisions is a good start – as identifying these in a large global business can be a task in itself. From that point, these items can be grouped into similar items and prioritised as required.

I think communication from banks on general progress across all corporates and any common themes, challenges and solutions will also be key. We are all going through similar experiences, yet with remote working and lack of face to face interaction with our peers (for a while longer), our banks can hopefully keep us updated as things develop even more over the year.

David, thank you so much for taking the time to answer all of these questions. The borrower perspective is so key in this transition and it really is invaluable to hear from your perspective, especially as a borrower who has some experience of a SONIA loan. This interview will be very helpful indeed for corporates, lenders and advisers.

No problem at all. We have all had to deal with a lot in the last 12 months and despite any ongoing challenges this is a very important topic, and one which only gathers more momentum as we head towards the end of this year – so I'm happy to share our experience so far.

David Plimmer,
Assistant Group Treasurer
National Express Group plc

Kam Mahil
Senior Director, Legal
LMA

To access the LMA LIBOR Microsite, please visit: www.lma.eu.com/libor.