LMA | Loan Market Association

Fallbacks to interbank term rates: Guidance on LMA documentation

1. Important notice

This note is intended as an overview and is not intended to be comprehensive. Whilst every care has been taken in its preparation no representation or warranty is given by the LMA or Clifford Chance LLP as to: (a) the accuracy or completeness of the contents of this note; or (b) the extent to which any documentary measure discussed in this note is effective to address any applicable regulatory or other requirement.

Most importantly, this note is not designed to provide legal or other advice on any matter whatsoever.

2. Introduction

(a) The transition from LIBOR to risk-free reference rates ("**RFRs**") illustrated the importance of robust and workable interest rate fallback provisions in loan documentation. Whilst LIBOR has now ceased to be published, certain interbank term rates[1] remain (for example, EURIBOR) with others expected to be discontinued (for example, JIBAR).[2] It is important that loan market participants learn from the lessons of LIBOR transition in order to mitigate any potential financial stability risks which may arise from the cessation of any other interbank term rate. One method of doing this is the inclusion of robust fallback language in new and refinanced interbank term rate-referencing loan documentation.

(b) LMA documentation in the context of LIBOR transition naturally developed in an iterative manner as the market worked through the process of identifying the reference rates being transitioned to and the appropriate documentary framework for use of such rates. It is important to understand the context in which the LMA's transition documentation developed to appreciate where such documentation is appropriate to use. Certain documentary provisions were products of their time aimed specifically at LIBOR transition and are not intended to constitute robust fallback provisions. Of the LMA's documentary provisions, only the Rate Switch Mechanism[3] (in line with the Official Sector guidance referenced below) constitutes a robust fallback.

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[1] In this note, the term "interbank term rate" is used to refer to a forward-looking rate, such as EURIBOR, which is set as of a given day for a given period of time in the future and which incorporates a credit premium and a term liquidity premium. For the avoidance of doubt, this term is not meant to include LIBOR as that rate has now ceased.

[2] Rates like EURIBOR and STIBOR are not currently expected to cease, however a cessation announcement is expected to be made in respect of JIBAR in South Africa in 2025.

[3] Defined in paragraph 8 below.

(c) The purpose of this note is to explain the approaches that were taken to LIBOR transition in LMA documentation, the contexts in which they were designed to be used and their applicability to transactions which use other interbank term rates (such as EURIBOR and JIBAR).

3. The importance of including robust fallbacks

(a) LIBOR transition showed the importance of adopting robust fallbacks in loan documentation. Without such fallbacks, it would be difficult to mitigate operational and market disruption risks in the event that an interbank term rate is discontinued or is declared non-representative.

(b) Whilst it is expected that any future cessation of an interbank term rate would be preceded by a notice period, it is clear from LIBOR transition that the process of legacy transition is not a short-term undertaking – the transition process requires significant time and resource. This is why it is advisable for market participants to act now to include robust fallbacks in documentation to mitigate any potential financial stability risks arising from any such cessation.

(c) This message has been reiterated by the Official Sector, as well as various currency working groups:

(i) The Financial Stability Board ("**FSB**") in its Final Reflections on the LIBOR Transition in July 2023 stated that: "*The FSB encourages all market participants to learn from the LIBOR transition experience and to adopt robust fallback mechanisms* ***in all cases****.*" (emphasis added)

(ii) The Working Group on Euro Risk-Free Rates ("**Euro RFR WG**") in its Guidance for Corporate Lending Products for Implementing the Recommendations on EURIBOR Fallback Trigger Events and €STR-based EURIBOR Fallback Rates states that: "*Robust fallbacks are a requirement of the EU Benchmarks Regulation (BMR) and the working group has previously stressed the importance of including robust fallbacks in all financial contracts,* ***not just those within the scope of the BMR****.*" (emphasis added)

(d) Certain jurisdictions have gone further by making robust fallbacks a requirement under local legislation. For example, in Italy, Article 118-bis of the Italian Consolidated Law on Banking includes an obligation on banks and intermediaries to include (by 10 January 2025) within relevant agreements clauses dealing with changes to a benchmark in case it materially changes or ceases to be provided. This is already having an impact on loan agreements, including outside of Italy. For example, English law governed syndicated loan agreements with Italian obligors and international syndicates are having to consider these requirements.

4. Cost of funds / replacement of screen rate language

(a) The LMA notes that the syndicated loan market has, in the context of interbank term rates, largely continued to use cost of funds as a fallback and/or replacement of screen rate language. The Official Sector have repeatedly stated that cost of funds and replacement of screen rate language are not workable long-term fallbacks. Specifically:

(i) The FSB in its Final Reflections on the LIBOR Transition stated that:

"*References to internal cost of funds or issuer or lender discretion should be avoided as primary fallbacks, as should references to fallbacks to be selected by a central bank or other official body unless consent for such reference has been granted by the authority named.*"

(ii) The Euro RFR WG in its Guidance for Corporate Lending Products for Implementing the Recommendations on EURIBOR Fallback Trigger Events and €STR-based EURIBOR Fallback Rates has stated that:

"*Cost of funds and replacement of screen rate language are not workable permanent fallbacks and do not provide scalable options in the case of a possible permanent discontinuation of EURIBOR.*"

(iii) The Working Group on Sterling Risk-Free Reference Rates ("**Sterling RFR WG**") in its Paper on the identification of Tough Legacy issues published in 2020 stated that: "*...the ultimate fallback in many syndicated lending agreements is to an individual lender's cost of funds. The Taskforce has concluded that such fallbacks are likely to be problematic for both lenders and borrowers for a range of reasons (including the difficulty of calculating the relevant cost).*"

(b) The fact that cost of funds and replacement of screen rate language are not robust long-term fallbacks is clearly demonstrated by the repapering exercise necessitated by LIBOR transition. It is also demonstrated by the interest shown by the Official Sector in progress on fallback implementation. It is therefore important that market participants take this into account when considering more robust fallbacks to interbank term rates.

(c) The LMA is pleased to have observed a move by some market participants to look to proactively embed robust RFR-based fallbacks to certain interbank term rates, including through operationalising fallback rates and working through internal approval processes (including in relation to €STR and ZARONIA). Others have indicated an intention to start in early 2025.

5. Spectrum of approaches to LIBOR transition

(a) The table below outlines the spectrum of approaches in documentation that the LMA produced specifically for LIBOR transition, with the least certain approach to transition on the left-hand side and the most certain on the right-hand side. In particular, only one of these (in line with the Official Sector guidance referenced above) constitutes a robust fallback.

(b) These approaches were originally designed to facilitate the means of potential satisfaction of documentary recommendations published by the Sterling RFR WG in 2020. The Sterling RFR WG recommended parties to include clear contractual arrangements to facilitate transition away from the use of LIBOR.

(c) Use of any of these approaches in the context of an interbank term rate will depend on whether there are clear recommendations in place as to a fallback or replacement rate for such interbank term rate.

Amendment approach (agree to agree)	**Amendment approach + fixed negotiation date + agreed key terms**	**Rate switch mechanism (fully hardwired approach)**
Revised Replacement of Screen Rate Clause	Revised Replacement of Screen Rate Clause plus Supplement plus RFR Terms	Rate Switch Mechanism[4]
Not a fallback. Designed to facilitate a future amendment process.	*Not a fallback. Designed to facilitate a future amendment process.*	*Hardwired fallback.*

(d) Each of these approaches and the circumstances in which they are designed to be used is explained further below.

6. Revised Replacement of Screen Rate Clause

(a) The LMA's revised replacement of screen rate clause ("**Revised Replacement of Screen Rate Clause**")[5] was first produced as a standalone publication in 2018. Whilst the end of LIBOR had been announced in 2017, there was no clarity as to the fallback or replacement rate for the loan market. The focus at that point was on facilitating the amendment process that would need to take place in due course.

(b) The Revised Replacement of Screen Rate Clause is not a fallback clause. Instead, it gives flexibility to make amendments to benchmark rate provisions with a lower consent threshold than may otherwise be required. It therefore relies on the parties reaching an agreement. There is no set date by which negotiations need to be concluded and therefore this approach does not provide certainty.[6]

(c) The approach taken in the Revised Replacement of Screen Rate Clause is only designed for use where there are no clear recommendations on the relevant

[4] This was originally included in the LMA's Rate Switch Facility Agreements as a mechanic to facilitate active transition away from the use of LIBOR. It has also been included in other LMA facility agreements which reference an interbank term rate from the outset as a mechanic to include a hard-wired fallback to that rate.

[5] See the "LMA Recommended Revised Form of Replacement Screen Rate Clause and Users Guide" available on the LMA website. This clause was subsequently incorporated into the LMA's suite of facility agreements.

[6] This lack of certainty was highlighted by the Sterling RFR WG's Loan Enabler Task Force which noted in a set of questions and answers that the Revised Replacement of Screen Rate Clause did not constitute an agreed process for renegotiation.

fallback or replacement rate to the relevant interbank term rate. This is not, for example, the case with EURIBOR or JIBAR where clear working group recommendations have been published as to the fallback or replacement rate. In such cases, parties should note the Official Sector and working group statements referred to in paragraph 4(a) above which advise against reliance on the Revised Replacement of Screen Rate Clause.

7. Supplement to the Revised Replacement of Screen Rate Clause and RFR Terms

(a) In 2020, the LMA produced a supplement to the Revised Replacement of Screen Rate Clause (the "**Supplement**"),[7] along with terms for the use of an RFR (the "**RFR Terms**")[8] to provide a more structured method for transition.

(b) Use of the Supplement, the Revised Replacement of Screen Rate Clause and the RFR Terms in conjunction with each other does not constitute a fallback clause and still relies on the parties reaching an agreement.

(c) The Supplement provides for the parties to specify a set trigger date for negotiations and an end date by which the changes should be agreed, with the parties undertaking to enter into good faith negotiations. It also allows the parties the option to set out pre-agreed terms, i.e. the RFR Terms (for example, what the replacement rate should be). The greater the number of terms that can be agreed and recorded, the greater the certainty for borrowers and lenders. However, it would still require negotiations to take place between the parties.

(d) This was an approach that was developed during LIBOR transition whilst further clarity was awaited on replacement rates but a set cessation date for LIBOR was known.[9]

(e) The use of this approach would be more appropriate where cessation of an interbank term rate has been announced but there are not yet clear established recommendations on replacement rates or market conventions for use of such rates. It allows more certainty for deals being negotiated at such a time. For example, the LMA produced documentation similar to this approach most recently for JIBAR transition.[10]

8. Rate Switch Mechanism

(a) The rate switch mechanism ("**Rate Switch Mechanism**") was first incorporated into LMA documentation in 2020 as a way of providing for a fully hardwired fallback to LIBOR and reflecting the published recommendations for the

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7 See the "Note on the Revised Replacement of Screen Rate Clause and documentary recommendations published by the Working Group on Sterling Risk-Free Reference Rates" available on the LMA website.

8 See the "RFR Terms for Replacement of Screen Rate Clause" available on the LMA website.

9 See the "Note on the Revised Replacement of Screen Rate Clause and documentary recommendations published by the Working Group on Sterling Risk-Free Reference Rates" available on the LMA website for context.

10 See the "LMA Recommended Revised Form of Replacement Screen Rate Clause and Users Guide for use in the South African market" and "RFR Terms for SA Revised Replacement of Screen Rate Clause" on the LMA website.

replacement rate for GBP LIBOR. It continues to be relevant where transaction documentation references interbank term rates.[11]

(b) The Rate Switch Mechanism provides for the interbank term rate to be automatically converted to an alternative rate on pre-agreed terms set out in the documentation on the occurrence of a specific trigger event (e.g. cessation of the interbank term rate). There is an option to provide an earlier agreed date should the parties wish to provide for active transition.[12]

(c) The Rate Switch Mechanism is a robust fallback in that it provides certainty to parties. It is a fully hardwired fallback clause which builds in all of the terms around using the fallback or replacement rate and does not rely on further agreement or negotiation between the parties or agent discretion.

(d) The Rate Switch Mechanism may be used even where there may be operational constraints in referencing RFRs at the time of the agreement to the extent that parties contemplate that such constraints will be overcome in the future. The Rate Switch Mechanism allows market participants to enter into transactions based on existing interbank term rates but allows a change in due course to the relevant RFRs. Market participants can therefore agree the terms relating to the fallback or replacement RFR at the point at which the transaction is entered into rather than having to enter into an extensive negotiation and amendment process when the cessation of the relevant interbank term rate becomes imminent.

(e) Agreements with the Rate Switch Mechanism are likely to be the most appropriate documentation method to use where there are clear working group recommendations that have been published as to the fallback or replacement rate to the relevant interbank term rate.

9. Going forward

(a) The LMA has provided the loan market with the documentary tools necessary to embed robust fallbacks through updates to documentation to reflect currency specific working group recommendations as to fallback or replacement rates to interbank term rates.

(b) The LMA continues to work closely with relevant currency working groups looking at fallbacks and transition away from use of interbank term rates, as well as its own IBOR working party and remains engaged with the Official Sector on this topic. The LMA has also established a EURIBOR Fallbacks Task Force to identify and mitigate perceived barriers to adoption of €STR-based fallbacks to EURIBOR.

(c) The LMA will continue to monitor the adoption of robust fallbacks to interbank term rates in the loan market given the statements of the Official Sector as to

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11 The Rate Switch Mechanism is incorporated into LMA facility documentation which provides for use of both interbank term rates and RFRs.

12 This option is more relevant where cessation of a particular interbank term rate is contemplated (as was the case for LIBOR).

the financial stability risks that may arise on the cessation of an interbank term rate where documentation contains inadequate fallbacks.