LMA Loan Market Association

Powering ahead: Shell's innovative approach to LIBOR transition and sustainability

In December 2019, Royal Dutch Shell plc ("**Shell**") announced that it had signed an innovative US$10bn revolving credit facility ("**RCF**"). The RCF was innovative for two reasons:

- First, in anticipation of the cessation of LIBOR, the RCF contains an in-built mechanism to switch from US$ LIBOR to the new Secured Overnight Financing Rate ("**SOFR**") – the chosen near risk-free rate ("**RFR**") in the US. This switch approach has since been used by British American Tobacco.
- Second, the interest and fees paid on the RCF are linked to Shell's progress towards reaching its short-term Net Carbon Footprint intensity target, as published in its Sustainability Report.

Kam Mahil, Senior Director - Legal at the LMA spoke to Michael Dawson, Head of Liquidity & FX at Shell about the transaction.

What was the driver to in-build SOFR to your RCF at that point in time and be the first mover?

The primary driver for this was really the duration of the facility. The facility is split into 2 tranches, with $8bn having a 5 year maturity. With LIBOR due to be discontinued by the end of 2021, we recognised that the facility would have required conversion to SOFR by then anyway and it therefore made sense for us to address this upfront. Of course, we also recognised that this was the first facility of its kind, and given the scale of Shell and our involvement with the Working Group on Sterling Risk-Free Reference Rates, we also wanted to help support industry transition.

How responsive and engaged were your relationship banks on LIBOR transition and the key points around moving to RFRs?

On the whole, the banking group was extremely supportive. Whilst there was some initial apprehension, this soon became recognition that this was an innovative solution that they could be part of. There was also recognition that this was structured in such a way as to give time to ensure they had sufficient time to ensure systems and processes were aligned, and thus was a relatively low risk approach.

Could you explain how the link to SOFR works and provide some insight into the conventions you used for calculating SOFR?

There are parts of this I can share, and parts that remain commercially sensitive. For the first year, the facility continues to price off LIBOR, but the conversion mechanism has been fully agreed in anticipation of conversion at the end of 2020. This includes an agreed LIBOR-SOFR spread. Our expectation continues to be that a compounded SOFR official screen rate will be published, to which margin will then be added. We intend to use a 5 day observation shift, rather than a lookback.

It's a very neat way of dealing with the issue of updates to loan systems. Of course, the systems piece is not unique to lenders and treasury management systems also need updating. What's been your experience on that side and how do you see that developing?

This is one of the major challenges we have noted, for lenders and ourselves, and was one of the mains reasons for deferral of the conversion date. We are aware of good progress from the relationship banking group, and thus remain positive about conversion to SOFR from the end of 2020.

Conventions have been a moving piece. Did you have discussions about what happens if conventions change after signing?

We certainly recognise that this is a moving target, and this was something that was discussed as part of the negotiations. We value highly the relationships that we have with o ur banking group, and we have always sought to achieve mutually beneficial outcomes. Were market conventions to change, we would certainly look to have that dialogue with the relationship group.

An RFR-referencing facility is quite different to a LIBOR based one. What where some of the other aspects of your facility which were driven by the nature of SOFR (for example, interest periods)?

We discussed this at great length as part of the negotiations, and I actually think we came up with a simple and somewhat elegant solution, simply fixing interest periods to 1 month. As previously mentioned, we have agreed the spread adjustment upfront, but for commercial reasons this is not something we can disclose.

Turning now to the other key aspect of your RCF and the link to Shell's Net Carbon Footprint intensity target. There is a lot of discussion in the sustainability market about how best to go about setting targets. Could you give our readers an insight into Shell's sustainability targets, the process you followed in setting those and the benefits of having a sustainability-linked loan?

This was something that we were very keen to include from the start, recognising the growth in number of facilities incorporating ESG components. We were very clear from early on in the process, that we wanted to link the facility to the targets that Shell already publishes, further strengthening our commitment to these targets. We therefore chose to link to the short-term Net Carbon Footprint targets, this is a measure of the emissions intensity of the portfolio of energy products that we sell. The calculation includes greenhouse gas emissions - on an equity basis - from several sources, including emissions directly from Shell operation; those third parties' emissions caused by supplying energy for that production of the products we sell; and our customers' emissions from consumption of the products we sell.

To access the LMA LIBOR Microsite and Sustainable Lending Microsite, please visit: www.lma.eu.com.