LIBOR transition is here – Facility agents at the ready

Make no mistake, LIBOR transition is here. With only a few days to go until 2021, the looming LIBOR transition deadlines are becoming a reality. Whilst there have been various announcements on 'tough legacy' solutions, raising the potential for synthetic LIBOR rates and the potential continued publication of key USD LIBOR tenors for a period to allow legacy run-off, the regulatory message remains clear. LIBOR transition is happening, the focus must remain on active transition and 2021 is the year where loan market participants must be ready to lend and borrow based on risk-free rates ("RFRs").

The transition from LIBOR to RFRs affects everyone in the syndicated loan market. With end-2021 fast approaching, the need to manage the transition of the legacy book and how to manage new RFR facilities shines a spotlight on the role of the facility agent in, and the approach of facility agents to, LIBOR transition.

Kam Mahil, Senior Director – Legal at the LMA spoke to Brian Fraser, Senior Manager, Lending Operations & Agency – IBOR, Markets & Lending Delivery at Lloyds Bank Commercial Banking about his views on the agency approach to LIBOR transition.

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

No problem Kam. Like everything IBOR, no one has written the guide manual. One thing is for sure, we all have to play our part in delivering what is a significant shift in how the loan market functions.

The LMA is often asked the question of who should take the lead on amendments to legacy loans for LIBOR transition. There is no "right answer" or requirement on the facility agent to be the party that initiates the process, however, we have seen some agents take a proactive approach to amendments. What approach has Lloyds adopted to its legacy loan book where it is acting as facility agent and why?

We have considered most options and there is no one approach that fits every transaction. For the bulk of our portfolio we are targeting a proactive Agent outreach. As Agent we will seek instructions as to whether the Lenders wish to commence the process of considering the transition away from LIBOR. We are seeking an efficient way forward for the lenders to be able to engage in collective consideration.

There is, I fear, a real risk of creating bottlenecks by not advertising that as Agent we can and will support positive traction should the lenders want to give us a mandate.

Given the characteristics of the loan market, the legacy loan book is not going to be subject to a one size fits all approach. In September, the Working Group on Sterling Risk-Free Reference Rates published a paper on active transition of GBP LIBOR referencing loans which contains some helpful steps for parties to consider when assessing their legacy loan book. What approach has Lloyds taken to dividing up and tackling its legacy loan book?

In our approach we are looking at both the construct of the facility, the syndicate composition and also our capacity to manage both the "amend and consent" process and day to day servicing. Agency and servicing colleagues need to test and learn RFR methodologies and get up to speed with a post-LIBOR world. We will seek to target syndicates initially where: (i) we see lenders who have been active in the RFR loan market; (ii) the construct of the transaction suggests that service is not overly onerous; and (iii) we believe that the facility will remain in its current form through cessation.

I am not naïve in my thinking that it is possible that either the lenders or the borrower(s) will have no appetite at the time of outreach to commence transition. The risk of multiple "false starts" is something that has to be accepted.

When reaching out to lending syndicates, are you approaching the syndicate with a suggested approach or providing any guidance?

In outreaching to the lenders, we will not provide any legal, regulatory or commercial advice or guidance in connection with LIBOR transition. We will ask that lenders consider their own obligations under applicable law and regulation when considering, discussing and negotiating transition matters. This will go along with caveats re commercially sensitive information (for example, pricing), as LIBOR transition touches upon competition law.

And in terms of borrower reaction and approach, what have been your experiences on their engagement to legacy transition? Do you think that will change as we go into 2021?

We have a number of borrowers who are keen to transition and so far they have met with mixed opinions from their lending groups. The work in progress is strong but getting deals over the line is difficult. Will it change in 2021? Well, we have all clearly seen that GBP LIBOR transition deadlines remain fixed, the use case for SONIA forward-looking term rates is restrictive so the borrower options are narrowing, and I am sure Agents do not want to run the risk of reverting to "cost of funds" rates.

I do see a further horizon risk that we all need to bear in mind. That is refinancing risk on the back of Covid 19 emergency funding lines and payment holidays. We need to be mindful that transition may actually mean refinancing and rather than a simple amendment the transition may have to be wrapped into a wider restructuring or negotiation. Query whether the market has got the capacity for a volume of such outcomes.

How are you planning to encourage engagement in those areas of the loan market which might not have been as active as the investment grade corporate market on legacy transition (for example, the leveraged market)?

We have to be active in as many segments as possible from as early as possible. In tracking lenders who have been active in the RFR market, we are seeking to target transactions where participants and systems will be able to cope with RFR based deals. Many lenders have significant testing to undertake as we all transition and as Agent I cannot be in a position where I leave all my actively traded or larger lender groups to the latter stages. The leveraged market will be one of the hardest to transition and this is where we see a greater refinancing risk (for example, equity driven and M&A deals). So we need to consider cases and timing carefully. Kam, before you ask, yes we do use the LMA RFR loan tracker to source valuable input to our outreach strategy. Thanks for collating and sharing this data with us and the wider market.

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Thank you for the plug Brian! I'm glad it has been helpful, and thank you to you for submitting deals to it. Turning to systems readiness, how has that impacted your approach?

We have worked closely with our infrastructure providers to ensure that we can cope with our planned demand. We have a phased deployment and testing of software upgrades and this has to be aligned with the outreach strategy. If, for any reason, there are breaks in full syndicate capability I certainly do not want to run my hardest syndicates manually. The cross-infrastructure reliance risk is big and many lenders are on this same journey, albeit we are all at different stages.

Have differences in currency approaches and conventions impacted your approach when it comes to multicurrency transactions?

In building our loan platform we have configured it such that we hope to cope with all current conventions and future changes. In documenting the required changes, we will focus similarly on the known markets and ensure that we have sufficiently robust fallback mechanisms imbedded. I am sure that all parties do not want to reopen documentation as and when non-sterling conventions get formalised and rolled out.

What approach are you taking to documentation? For some legacy transactions, are you contemplating moving those to a rate switch if the parties are not ready to move directly to RFRs?

We will certainly be seeking lender and borrower views on a collective approach. We have built infrastructure to support both straight to RFR and transition with pre-agreed conversion terms at a future date. Like all things IBOR related, we have to be agile in our considerations and extremely careful to ensure the linkages are robust for operating what we are mandated to deliver as Agent. Loan documentation and servicing is becoming more complex and all currencies not transitioning in tandem does create added risk, elongated servicing and undoubtedly increased cost of service to many Agents.

How about the approach to taking on new deals? There is a lot of interest in the market around who is acting as facility agent on RFR deals and how they get themselves comfortable with that role. What are the considerations on your side in taking on a facility agent role on an RFR facility?

During the IBOR transition process so far, there have been many instances where I have sought to ask the question "How do I operationalise that?" and this remains my first thought. What is the ask here, can I deliver it and what are the risks? The added RFR complexity, the harder maths and operational compression may in some cases lead to fewer Agents having the appetite to manage deals or a tightening of some of the operational language.

We have seen deals coming to market with restrictions in the number of prepayments, an insistence that prepayments come with interest and we all need to be careful that the product that was LIBOR is not turned into a manual overdraft or swingline facility. Agents going forward may not have the same option to deliver "favours" for borrowers, for example, last minute requests and short notice breaks. This is because the capacity to run an Agency book will be stretched, at least in the early days, until everyone gets up to speed with what is needed. Care has to be taken that the Agent is not seen as the educator – too often historically there has been a leaning on the Agent to explain, assist or help out participants. I see this reducing.

Brian, thank you so much for taking the time to answer all of these questions and there is certainly a lot there for facility agents and loan market participants to be thinking about. I think this interview will be really helpful insight for facility agents, but also more generally for loan market participants considering LIBOR transition.

Kam, always happy to assist and share my views. We all have a distance to go to ensure that each institution puts itself in the best place possible to ease transition. Juggling internal demands, meeting regulator deadlines whilst ensuring that we bring borrowers and lenders with us will have to be high on our list of priorities for 2021.

Kam Mahil, Senior Director
Legal at the LMA

Brian Fraser, Senior Manager, Lending Operations & Agency
IBOR, Markets & Lending Delivery at Lloyds Bank Commercial Banking

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