The transition from LIBOR to risk-free rates: taking stock and looking forward

In the last LMA newsletter (H2 2018), the article "Developments in respect of LIBOR and the move to risk-free rates" provided an update on developments in respect of each of the LIBOR currencies and the LMA's continued work on LIBOR transition. Work is continuing to progress on alternative risk-free rates ("**RFRs**") in each of the LIBOR currencies, however, there is still as yet no obvious alternative to LIBOR for the syndicated loan market. In July 2018, Andrew Bailey, Chief Executive of the Financial Conduct Authority ("**FCA**"), made it clear that the discontinuation of LIBOR "*should not be considered a remote probability 'black swan' event*". Market participants need to treat this as "*something that will happen and which they must be prepared for*". It is therefore important for market participants to be up to speed on developments and actively participate in identifying suitable alternative rates for the loan market.

This article provides an update on the LMA's work on the transition away from LIBOR and a summary of the most recent developments in respect of each LIBOR currency as we look forward to 2019.

RFRs in the LIBOR currencies

The RFRs identified by the various currency working groups in the LIBOR currency jurisdictions are set out in the adjacent table.

The LMA's transition work

The LMA remains in active discussions with the relevant regulators and national working groups to ensure that the interests of the loan market are represented. In particular, the LMA is a member of the sterling, euro and Swiss franc working groups. 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, LSTA (which is a member of the US working group), APLMA, ICMA, ISDA, AFME and others). Minutes of the monthly meetings that take place between these associations on LIBOR transition are now available on the LMA LIBOR Microsite (as well as the websites of other participating associations).

Kam Mahil,
Director, Legal – LMA

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 is intended to provide an overview of developments and key issues and has been updated to cover each LIBOR currency. LMA and ACT members can use the guide as a basis for presentations and discussions with counterparties. The release of the updated guide coincided with a LIBOR panel at the LMA Syndicated Loans Conference, which had representatives from the FCA, the Working Group on Euro Risk-Free Rates and the LSTA. A video of the panel is available on the LMA website.

In terms of LMA documentation, the LMA published its "Revised Replacement of Screen Rate Clause" on 25 May 2018 (subsequently updated in October 2018). The clause is designed to provide further flexibility than the earlier clause allows to transition to a new rate, as it permits amendments with a lower consent threshold than may otherwise be required in a wider range of circumstances. It was developed in conjunction with members of the LMA and the ACT and is of application across different LIBOR currencies. The revised wording also allows for various consequential amendments to be made, including amendments to preserve economic value. In October 2018, the clause was made publicly available on the Bank of England website (as the Bank provides the Secretariat for the Working Group on Sterling Risk-Free Reference Rates). The wider publication of this language marked an important step in raising awareness of the implications of the transition away from LIBOR and the need for parties to consider appropriate provisions in documentation referencing LIBOR.

Currency	Chosen Risk-Free Rate	Secured/ Unsecured	Working Group
Sterling	SONIA (Sterling Overnight Index Average)	Unsecured	Bank of England Working Group on Sterling Risk-Free Reference Rates
US Dollar	SOFR (Secured Overnight Funding Rate)	Secured	Alternative Reference Rates Committee
Euro	ESTER (Euro Short-Term Rate)	Unsecured	Working Group on Euro Risk-Free Rates
Swiss Franc	SARON (Swiss Averaged Rate Overnight)	Secured	Swiss National Working Group
Japanese Yen	TONA (Tokyo Overnight Average Rate)	Unsecured	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks

Throughout 2018, a lot of work has been ongoing on transition through the individual currency groups. An update on that work is set out below.

Sterling – SONIA

In July 2018, the sub-group on term SONIA reference rates published a consultation on its findings on use cases for forward-looking term rates, as well as potential methodologies for such term rates. The consultation closed on 26 October 2018 and the Working Group on Sterling Risk-Free Reference Rates published a summary of responses in November 2018. The responses show that there is strong support for a forward-looking term rate in certain cash market segments. The LMA had responded to the consultation setting out the need for forward-looking term rates for the loan market (see further the joint LMA/ACT paper on syndicated loans and forward-looking term rates). The Working Group will now discuss the summary at its forthcoming meetings, including the steps necessary to catalyse further developments. A development in 2018 which could assist the development of a forward-looking term rate was the launch by Intercontinental Exchange ("**ICE**") and CurveGlobal respectively of three-month SONIA futures (with ICE also having launched one-month SONIA futures in December 2017).

In addition to work on a forward-looking term rate, the Sterling working groups are continuing to discuss best practice for referencing SONIA in cash markets (for example, by compounding over the interest period). A communication on this is expected by the end of 2018.

The importance placed on transition by UK regulators was highlighted in September 2018 when the FCA and the Prudential Regulation Authority wrote 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 rate benchmarks. The purpose of the letters is to seek assurance that firm senior managers and boards understand the risks associated with the transition and are taking appropriate action. Responses are due by 14 December 2018.

US Dollar – SOFR

In July 2018, the Alternative Reference Rates Committee ("**ARRC**") published guiding principles for the development of fallback language for new financial contracts for cash products to ensure they will continue to be effective if US Dollar LIBOR ceases to be produced. Subsequently in September 2018, the ARRC published consultations on draft fallback language in floating rate notes and syndicated business loans. The aim of the consultations is to establish consistency in defining key terms, including by defining: a "trigger event" which would start a transition from LIBOR; a "successor rate waterfall" which would identify the LIBOR replacement rate; and a "spread adjustment" waterfall which would specify the spread adjustment to be applied to the replacement rate due to the differences between LIBOR and SOFR.

The syndicated loans consultation proposes two different approaches: (i) a "hardwired approach"; and (ii) an "amendment approach". The consultation closed on 26 November 2018 and the LMA submitted a response to that consultation outlining the elements of the proposals which are likely not to be workable in EMEA. The ARRC is expected to issue final contract language recommendations for floating rate notes and syndicated business loans for voluntary use by market participants based on the consultation results.

In October 2018, the ARRC published an update on its progress. This included a timeline in which the ARRC states that it is seeking to produce an indicative SOFR-based term reference rate based on futures data to help promote market familiarity with the term rate in Q1 2019. CME Group launched one- and three-month SOFR futures in May 2018 and ICE launched the same in October 2018, which will assist in this regard.

LMA and ACT paper on syndicated loans and forward-looking term rates

This joint publication by the LMA and ACT considers the use of forward-looking term rates in the syndicated loan market. In particular, it covers the key features of syndicated loans impacted by the transition from LIBOR to overnight risk-free rates, along with the implications for both borrowers and lenders of the transition.

https://www.lma.eu.com/application/files/3815/3207/8763/LMA_ACT_Paper_on_Forward_Looking_Term_Rates_July_2018.pdf

Euro – ESTER

In September 2018, the Working Group on Euro Risk-Free Rates selected ESTER as the euro RFR following a public consultation (which closed in July 2018). ESTER is a new unsecured overnight rate to be published by the ECB by October 2019. This completed the first work stream of the group and the focus is now on: (i) identifying and recommending term structures; (iii) investigating contractual robustness for both legacy and new contracts; and (iv) EONIA transition.

In relation to EONIA, the European Money Markets Institute ("**EMMI**") has previously stated that it will not proceed with work to reform EONIA. Therefore, under the EU Benchmarks Regulation ("**BMR**"), EONIA may still be used as a reference rate until 31 December 2019 (under the transitional provisions). After 1 January 2020, the provision and use of EONIA in existing contracts may be permitted by the Financial Services and Markets Authority, under the conditions set out in the BMR. The Working Group is therefore effectively working to an end-2019 deadline for transition to ESTER. However, given that ESTER may only be published in October 2019, this does not give sufficient time for an orderly transition. The Working Group therefore published a high level implementation plan in September 2018 which contains a request to the European co-legislators to extend the BMR deadline by two years to ensure sufficient time for the transition. This is currently being debated as part of the European legislative process. In the meantime, the Working Group is still striving to achieve transition from EONIA to ESTER by 1 January 2020. To this end it is planning to publish a recommendation on an EONIA transition path by the end of 2018.

In terms of EURIBOR, EMMI launched a second consultation on its hybrid methodology in October 2018. This follows a pre-live testing phase which took place between May and August 2018. The consultation closed on 30 November 2018. EMMI aims to complete the reform process for EURIBOR, and achieve BMR approval, by Q4 2019 at the latest. As the result of this process is still uncertain, the Working Group is looking at ESTER-based term rates as a fallback to EURIBOR. It is expected that a consultation paper on such term rates will be published by the end of 2018. Several methodologies are under review, including futures-based and OIS-based methodologies. Backward-looking methodologies are being considered separately.

Swiss Franc – SARON

The National Working Group on Swiss Franc Reference Rates ("**NWG**") has been conducting corporate outreach and assessing the feasibility of different term rate approaches. The corporate outreach found that the most important characteristics of a reference rate were an official fixing and knowing the payment at the start of the interest period.

SARON futures have been under consideration as an option in assisting the creation of a forward-looking term rate. In order to assist the development of such futures, in June 2018 the NWG released recommended specifications for 3-month SARON futures contracts. 3-month SARON futures have been trading on Eurex as of 29 October 2018.

On 31 October 2018, the NWG determined that, given the specific characteristics of the Swiss market, it was unlikely at this stage that a robust derivatives-based term fixing was feasible. The NWG has therefore recommended using a compounded SARON wherever possible (whether on a forward-looking or backward-looking basis). However, the NWG has recognised that there are segments of the market which are reliant on forward-looking term rates (particularly multicurrency products) and the derivatives-based term fixing will be kept under review. The NWG is now focusing on further understanding the needs of corporates, operational readiness and potential legal challenges. The NWG is due to meet again in February 2019.

Japanese Yen – TONA

In August 2018, the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks was formed by the Bank of Japan to facilitate the use of Japanese yen interest rate benchmarks. Three sub-groups have been established focusing on: (i) loans; (ii) bonds; and (iii) development of term reference rates. A public consultation on the conclusions of the Committee is expected in 2019.

ISDA consultation on adjustment spreads

An important issue in the transition to RFRs is how to account for the difference between LIBOR and the RFRs (which are overnight, backward-looking rates, without a term structure or credit component). Following a request from the Financial Stability Board, ISDA is in the process of amending its standard documentation to implement fallbacks for certain key IBORs to the identified RFRs. It launched a consultation in July 2018 (which closed on 22 October 2018) seeking input on the approach for addressing certain technical issues associated with the term and spread adjustments that will apply to the RFRs if the fallbacks are triggered.

Whilst the consultation was focused on derivatives, any outcomes could impact the cash markets either directly or indirectly. As a result, the consultation was open to all market participants (not just ISDA members). The LMA did not respond to the consultation (as ISDA requested feedback directly from market participants), but did put out a Spotlight interview to help market participants understand the approaches suggested for the term and spread adjustments.

In November 2018, ISDA published the preliminary results of its consultation. Based on the feedback received, ISDA expects to proceed with developing fallbacks based on the compounded setting in arrears rate and the historical mean/median approach to the spread adjustment for all of the benchmarks covered by the consultation. ISDA expects to publish more detail on the results and a final decision on the approach it intends to adopt by the end of December 2018.

Developments concerning ICE Benchmark Administration

To assist with the debate on term structures, in October 2018, ICE Benchmark Administration Limited ("**IBA**") launched the ICE Term RFR Portal and published a paper on potential term structures for the RFRs. IBA is requesting feedback on the proposed methodologies to derive forward-looking term rates set out in the paper (including as to timing of publication and tenors). We would encourage LMA members to respond directly to IBA on these proposals.

In addition, in December 2018, IBA launched a survey on the use of LIBOR currencies and tenors. The survey is intended to assist IBA in identifying the LIBOR settings that are most widely used and to inform its work in seeking the support of globally active banks for the publication of certain LIBOR settings post-2021. IBA has stated that the primary goal of this work is to provide those LIBOR settings to users with outstanding LIBOR-linked contracts that are impossible or impractical to modify, but it is not intended as an alternative to the transition to RFRs. We would encourage LMA members to complete the survey, which closes on 15 February 2019.

Developments in other currency jurisdictions

This article has focused on the LIBOR currency jurisdictions, however, interest rate benchmark reform is also taking place in other currency jurisdictions. For example, in August 2018, the South African Reserve Bank released a consultation on reform of key interest rate benchmarks used in South Africa, as well as proposals on a suite of new alternative benchmarks. Another example is Canada, where an alternative reference rates committee was set up in March 2018 to identify and develop a new term RFR for Canadian dollars to operate alongside the existing Canadian Dollar Offered Rate ("**CDOR**"). The committee will also review and explore possible enhancements to the existing Canadian overnight RFR.

It is also important for LMA members to ensure that they keep themselves informed of developments and actively take part in the debate and respond to industry consultations to ensure the voice of the loan market is heard.

The LMA is monitoring developments in other currency jurisdictions, particularly those that impact its documentation, and we would encourage LMA members to monitor developments in the jurisdictions relevant to them.

The year ahead

Looking forward, key decisions in respect of LIBOR transition are expected to be made in 2019. In particular, the market is expected to receive clarity as to the availability of forward-looking term rates. The LMA will continue to represent the interests of the loan markets on the working groups and work on documentation. It is also important for LMA members to ensure that they keep themselves informed of developments and actively take part in the debate and respond to industry consultations to ensure the voice of the loan market is heard.

The LMA will of course continue to update the LIBOR microsite to keep members informed of the latest developments and will be holding regular LIBOR seminars across Europe, the Middle East and Africa in 2019. ■

LMA LIBOR microsite

www.lma.eu.com/libor

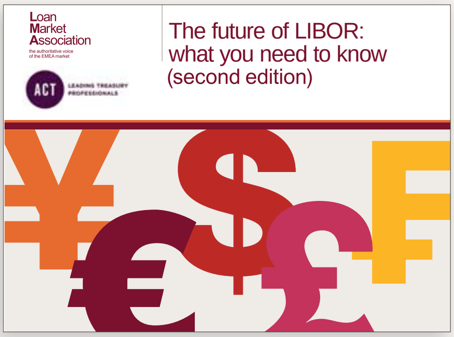
We continue to work with the market, other trade associations and the regulators on the transition from LIBOR to risk-free rates.

Our dedicated LIBOR microsite contains all content related to these discussions and is updated frequently with the latest developments. Please remember to check-in regularly to ensure you stay up-to-date with the latest news and ways you can take part in the debate.

The microsite houses a variety of content including:

– The latest Legal & Regulatory News;
– Submissions by the LMA to important consultations, including the sterling term rate consultation;
– Briefing notes and articles produced by the LMA and member law firms (including the LMA and ACT paper on syndicated loans and forward-looking term rates);
– Spotlight interviews (please see Spotlight section on page 11);
– Education & Events: new upcoming events, webinars and video recordings from past events;
– Documentation: the revised Replacement of Screen Rate clause;
– Publications;
– Currency Working Groups: links to the webpages of key Currency Working Groups.
– Trade Association Working Group: links to minutes of the meetings of the Group and other joint materials.

LMA and ACT Guide – The future of LIBOR: what you need to know (second edition)



We have updated our joint guide with the ACT on LIBOR benchmark reform entitled “The future of LIBOR: What you need to know”. The Guide is intended to provide an overview of developments and key issues with respect to the proposed transition away from LIBOR benchmarks to near risk-free rates (“RFRs”). We hope that this Guide provides a useful resource for members and have made it available in both pdf and powerpoint format should members wish to use the materials for presentation purposes (whether internally or to clients).

https://www.lma.eu.com/news-publications/lma-guides

Video: Life beyond IBORS: finding sustainable benchmarks for the loan market

On the LMA website is a recording of the IBOR panel session from our annual conference in London on 25 September.

Speakers were:

Chair: **Clare Dawson,** Chief Executive – LMA; and panellists: **Mark Campbell,** Special Counsel – Clifford Chance; **Brian Fraser,** Senior Manager, Loan Operations – Lloyds Banking Group; **Ellen Hefferan,** Executive Vice President of Operations & Accounting – LSTA; **Jaap Kes,** Head of Market Risks & Execution – ING Group Treasury; and **Edwin Schooling Latter,** Head of Markets Policy Department – FCA.

https://www.lma.eu.com/education-events/video/life-beyond-ibors