LMA Syndicated Loans Conference
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Life beyond IBORs: finding sustainable benchmarks for the loan market

The potential discontinuation of IBORs is one of the most important issues for the loan market. The panel considered the issues stemming from this and discussed the way forward.

The panel was chaired by **Clare Dawson**, Chief Executive of the **LMA**. Clare was joined by **Mark Campbell**, Special Counsel at **Clifford Chance**; **Brian Fraser**, Senior Manager, Loans Operations at **Lloyds Banking Group**; **Ellen Hefferan**, Executive Vice President of Operations & Accounting at the **LSTA**; **Jaap Kes**, Head of Market Risks & Execution at **ING Group Treasury**; and **Edwin Schooling Latter**, Head of Markets Policy Department at the **FCA**.

Progress so far

Progress has been promising as alternative benchmarks have been identified and there are efforts to build liquidity in these rates. The UK has decided to adopt SONIA for sterling, the US Alternative Reference Rates Committee (ARRC) agreed on SOFR and the Euro Working Group has most recently identified ESTER as its preferred risk-free rate. In respect of SONIA, liquidity is building on the derivatives side and we have seen the first SONIA referencing floating rate notes. However, term rates are important for the loan market and, as yet, there are no term rates available for any LIBOR currency. However, there are plans to create term rates and a consultation was published by the Sterling Risk-Free Rate Working Group on SONIA term rates (which closed on 30 September).

The Euro perspective

As EONIA will not be compliant with the EU Benchmarks Regulations (BMR), it will be replaced by ESTER (which the European Central Bank will publish by October 2019). The Euro Working Group has been in dialogue with the working groups of other states which have been open to information sharing in an effort to facilitate mutual learning.

Four working groups have been established; to first find the new risk-free rate (now complete); second to find term rate methodologies (various methodologies have now been identified); third to look at contracts and fallbacks; fourth to look at transitional issues related to EONIA.

The US dollar

Progress has been made in terms of fallback language in the US and the ARRC has issued a consultation on loan fallback language. This comprises two approaches: an amendment approach and a hard-wired approach. Both approaches consist of four components: (i) the triggers for transition from LIBOR to a new rate; (ii) what the new rate is; (iii) the spread adjustment to account for the difference between LIBOR and the new rate; and (iv) the mechanism to amend the loan agreement.

The amendment approach allows for flexibility but could mean thousands of credit agreements would need to be amended. It could also allow for winners and losers to emerge depending on the point of the credit cycle.

The hard-wired approach sets out a defined waterfall for the new rate, starting with term SOFR (which does not yet exist), then compounded SOFR (which does not yet exist as a published rate) and finally overnight SOFR. The adjustment spread would be that recommended by the ARRC or the Federal Reserve, or failing that as defined by ISDA (although note such a spread would be tailored to the derivatives rather than loans market). If parties go through this waterfall without being able to determine a fallback rate, a streamlined amendment process would apply.

Cross currency cooperation

Different timetables apply in respect of the work across the LIBOR currencies and there are key differences in the chosen alternative nearly risk-free rates. Three currencies have adopted an unsecured overnight rate, whereas two have adopted secured overnight rates. Nonetheless, such differences can be overstated as in each case the predominant objective is to establish a nearly risk-free rate with a minimal credit element. The different authorities have also worked well together over the past 18 months.

The loan market's ability to shift to risk-free rates

Banks have readily participated in the currency working groups and a few have now issued SONIA-referencing bonds. The current position, however, is that the solutions for the loan market are uncertain. This could be addressed by creating more certainty so that operational issues can be dealt with. As banks prepare to make operational changes to aspects such as their core lending platforms, there must be clearly defined solutions available.

Using a daily overnight rate for loans would cause operational issues, for example it would require a loan to be re-rated daily. Backward compounding also poses a logistical challenge and there are many issues to be worked through. The market preference is clearly for a forward-looking term rate. While it would be possible to draft documentation for a backward looking daily compounded SONIA rate, there has been a lack of enthusiasm to adopt this approach given the operational difficulties.

Most agents operate across all the impacted currencies. Whereas currently rates are available at one point in time across a range of published rates, a move to different publication times would require a degree of operational engineering to deliver a non-fragmented service. Agents will also need to deal with the fact that the transition to new rates (and the associated spread adjustment) could occur at different times for different currencies. Education is a key component that must be implemented for operations staff who must understand the new benchmarks, as well as their implications and timings.

Progress on documentation and next steps

There has been since 2014 optional LMA Replacement of Screen Rate language which allows for amendments to documents to provide for a new rate with majority lender and borrower consent. Since then, an amended form of the Replacement of Screen Rate language has been published, which provides for more flexibility. The clause is triggered on the occurrence of a particular event, wider than just the screen rate ceasing to be available. The new wording can be triggered earlier, such as by virtue of an announcement that the screen rate could no longer be used in the future. This revised form allows for various amendments to be made to the documentation to take account of the differences between a LIBOR-based rate and a risk-free based rate.

The sterling loans sub-group is in the process of producing a note on issues associated with new and legacy loan documentation referencing LIBOR. LMA members have also been encouraged to respond to the consultation on forward-looking SONIA-based term rates, which constitutes a key issue for the market. The amendment of legacy documents will be easier once the uncertainty around term rates is resolved. The sub-group is also working on appropriate fallbacks to risk-free rate based benchmarks.

The SONIA term rate consultation closed on 30 September. Responses will be considered and the Sterling Working Group will determine whether there is any consensus and what should be the best solution. Subsequently, an administrator would need to be selected to publish the term rate. Preliminary outcomes from the consultation should be clearer in the next 6 months.

Multi-currency facilities

It was noted that LMA documentation already contains drafting for non-LIBOR currencies with schedules setting out key terms in relation to operational issues related to the local benchmark rate. SOFR or SONIA schedules could be created and sterling and US dollar treated as non-LIBOR currencies. Nonetheless, it needs to be borne in mind that the current non-LIBOR currency schedules are based on forward-looking rates only and do not accommodate backward looking overnight rates.

Awareness, engagement and international coordination

Awareness is on an upwards trajectory. However, developments are still occurring at different points in time for different currencies.

The mechanism for international coordination is through the Financial Stability Board (FSB) Official Sector Steering Group. The issues with LIBOR discontinuation are similar across all jurisdictions. There has been substantial dialogue between working groups to ensure consistency and coordination, however, consensus must be reached in each group on what the right outcomes are to allow the market to make constructive progress.

The LMA has been involved in the Sterling, Euro and Swiss franc working groups, and is focused on raising awareness and educating the market on what the issues are. The LSTA is doing the same in respect of the US.

Consciousness of the impact of the transition from IBORs is rising, but there are still those who have not yet heard or have failed to hear the message. However, as emphasised in Andrew Bailey's speech in July, the discontinuation of LIBOR is not a black swan event and firms should prepare accordingly. The FCA and the Bank of England have recently undertaken steps to ensure that preparations by systemic banks are underway. The transition is an issue which everyone needs to be prepared for.