In Practice

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Amending legacy contracts

In this In Practice piece the author considers the various approaches to documenting amendments to legacy contracts to cater for near risk-free rates.

Following the Financial Conduct Authority's announcement on 5 March 2021 that all LIBOR settings will either cease to be provided by an administrator or no longer be representative immediately after 31 December 2021 (in the case of all but the most commonly used USD LIBOR tenors), market participants have focused in earnest on the amendment of legacy facility agreements to cater for near risk-free rates (RFRs).

The Working Group on Sterling RFRs imposed an interim milestone of 30 September 2021 for conversion of all legacy sterling LIBOR facility agreements to RFRs where possible, and the Loan Market Association (LMA) has published recommended documentation using compounded RFRs which effect the Working Group's Best Practice Guide for GBP Loans. However, there are a significant number of legacy loans which still refer to LIBOR, so there will be substantial pressure on resources in Q4.

The lender consent level required to make the amendments to the interest rate calculation provisions to replace LIBOR with the relevant RFR will depend on the terms of the underlying facility agreement. The LMA published its replacement of screen rate language in 2018 and this was included in many facility agreements to enable amendments to be made to the reference rate with majority lender (2/3 lenders) rather than all-lender consent. The LMA's reference rate selection agreement was intended to streamline the amendment process, whereby the main commercial terms of the RFRs would be agreed by the requisite group of lenders and the company and then documented on LMA recommended terms with only the agent's and the company's input. However, this dual-step amendment process is rarely used in practice and instead heads of terms are usually agreed commercially and then documented in a single-stage amendment process.

The approach to documenting the amendment varies: a short amendment letter, which lists a relatively limited number of amendments, could be used, or a full amendment and restatement agreement. Some lenders have developed standard form "override" agreements, which are intended to be used to amend any loan agreement without being made bespoke to maximise efficiency. The cost advantages of using either a simple amendment letter or a standard override agreement are obvious but weighed against that is the fact that the amendments required are complex, fundamental and affect a number of clauses, so reading across from a separate amendment document to a facility agreement in several months' time might not be easy.

The amendment process itself is coloured by the fact that this is a market-driven, rather than borrower-requested process, and costs (and who bears them) will be key. Given the fundamental nature of the change to the interest rate, lenders may require all obligors to sign the amendment document, and a confirmation of any guarantees (and security) may be included for completeness. However, where the replacement of LIBOR was clearly contemplated in the underlying document, in some markets lenders may be comfortable with an obligors' agent signing on behalf of the other obligors.

Extensive conditions precedent such as legal opinions and corporate authorisations would add significantly to the cost of the exercise, and whether they are required will often depend on the jurisdictions involved (and which party will bear the cost). Similarly, the extent to which new security is required will depend on the jurisdictions concerned: since the replacement of LIBOR with RFRs is intended to be economically neutral, the analysis may again largely depend on whether the change was in the contemplation of the parties when the underlying facility agreement was entered into and any security taken.

Negotiating documents could also significantly add to the legal fees involved, so many parties are agreeing the commercial terms of the RFRs in heads of terms, and then following closely the LMA recommended drafting in documenting the amendments. Often where parties wish to deviate from the LMA approach, providing a mark-up of the changes they intend to make will be helpful.

However, there is still divergence in the fundamental issue of the reference rate to be used and how it is calculated. The loan market conventions differ from those used by ISDA, and there is currently no screen rate analogous to the Bloomberg rate that is used in ISDA documents. Some lenders prefer to use a cumulative compounded methodology to calculate the reference rate over an interest period, rather than a daily non-cumulative compounded rate. The regulatory use case for term rates is limited for some currencies, such as sterling, and there will be no term rate for Swiss francs. However, in the US with the far larger USD derivatives market, a term rate has been formally recommended by the Alternative Reference Rate Committee for use in syndicated loans in some circumstances. So, despite the looming deadline for transition, there is still scope for uncertainty and a diversity of approaches, particularly in multi-currency facility agreements where the parties wish to avoid multiple amendment processes. ■

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