LIBOR TRANSITION: THE NEXT STEPS IN THE LOANS MARKET

15 July 2020 | Insight
Legal Briefings – By **Will Nevin and Emily Barry**

Despite Covid-19 slowing LIBOR's phase-out, the loan market still faces the move to risk-free rates by 2022. We assess the progress

The relaxation of the interim milestones in the transition from LIBOR to near risk-free rates (RFRs) in the loans market, in recognition of the challenges faced by businesses in their response to the Covid-19 pandemic, has been helpful. However, the overall assumption remains that firms cannot rely on LIBOR being published after the end of 2021. Furthermore, the sterling RFR working group still recommends that by the end of Q3 2020 lenders should be in a position to offer non-LIBOR-linked loan products to their customers, and all new issuance of sterling LIBOR-referencing loan products that expire after the end of 2021 should cease by the end of Q1 2021.

Recent transactions contemplating a switch from LIBOR-based loans to those based on the sterling RFR, SONIA, and the USD RFR, Secured Overnight Financing Rate (SOFR), with the mechanics post-switch being fully documented from day one, have led to in-depth consideration of the issues faced by the loans market in using overnight, backward-looking rates in place of forward-looking term LIBOR.

The publication of a SOFR index and SOFR averages by the New York Fed, and the decision by the Bank of England to publish a SONIA index from August, has helped in establishing conventions in determining compounded average rates for use in facility agreements on a consistent and transparent basis.

This area is developing rapidly, which throws a greater spotlight onto the fallback regime in place since this will:

- set the parameters for a screen-based compounded RFR, if one were to become available;
- determine how the reference rate would be calculated if no screen-based compounded RFR is available; and
- set out the ultimate fallbacks in case of unavailability in the usual way.

In addition, the challenges of documenting multi-currency loans using the different RFRs required for each currency remain significant. The continuation of EURIBOR exacerbates this in the short term and raises the spectre of loan agreements which partly contemplate a forward-looking mechanic for euro loans and partly contemplate a backward-looking one for sterling and US dollar loans.

Some points, such as the adjustment spread applied to the RFRs, require further consensus and may benefit from further public sector engagement. Other points, which are predicated on loan agreements being priced on the basis of lenders' cost of funds, such as broken funding costs and whether the RFRs should be linked to lenders' cost of funds at all, may be resolved differently for a revolving credit facility with a strong relationship dynamic and a more arm's length, leveraged transaction where active secondary trading in the debt is likely. In fact, any requirement to calculate or apportion interest mid-interest period will need to be given careful consideration.

However, the documentation issues have now been worked through in practice, in a collaborative and thoughtful way, on at least one transaction. So once the operational systems are in place to move to RFR-based loans, the Sterling Working Group's recommended milestones should be capable of being met.

This article was first published on www.ukfinance.org.uk

RELATED TOPICS

Sector Viewpoints

FEATURED INSIGHTS

FEATURED INSIGHTS

HELPING YOU STAY AHEAD OF THE BIG ISSUES

BROWSE BY:

- TECH, DIGITAL & DATA

- GEOPOLITICS AND BUSINESS

- NEW BUSINESS LANDSCAPE

RELATED ARTICLES

UPDATED: UK NATIONAL SECURITY ACT 2021 - WHAT INVESTORS NEED TO KNOW

Foreign investment: Rising tides of politics in regulation

Comply or Explain to climate-related reporting – A cross-industry roadmap

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

WILL NEVIN
PARTNER, LONDON

+44 20 7466 2199
will.nevin@hsf.com

EMILY BARRY
PROFESSIONAL SUPPORT CONSULTANT, LONDON
+44 20 7466 2546
Emily.Barry@hsf.com