LIBOR TRANSITION UPDATE

The anticipated transition from London inter-bank offered rate (**LIBOR**) to alternative risk free rates (**RFR**) continues to develop, though the impact of current Covid-19 pandemic has now been recognised in the recommended timetable. The incoming changes were discussed in our July 2019 Real Estate Finance Update, which can be read here.

A 23 March 2020 statement from the Bank of England (**BoE**), the Working Group on Sterling Risk-Free Reference Rates (**RFRWG**) and the Financial Conduct Authority (the **FCA**) confirmed that the various major benchmark reform milestones set in relation to the Sterling RFRs should still be targeted, given their view that "*the transition from LIBOR remains an essential task that will strengthen the global financial system*".

However, in the context of the Covid-19 pandemic, on 29 April 2020 the RFRWG released the following statement "*…the FCA and the Bank of England recognise that it will not be feasible to complete transition away from LIBOR across all new sterling LIBOR linked loans by the original end-Q3 2020 target. There will likely be continued use of LIBOR-referencing loan products into Q4 2020 in particular, to maintain the smooth flow of credit to the real economy. Taking this into consideration the RFRWG recommends that:*

- *By the end of Q3 2020 lenders should be in a position to offer non-LIBOR linked products to their customers;*
- *After the end of Q3 2020 lenders, working with their borrowers, should include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion ahead of end-2021, through pre-agreed conversion terms or an agreed process for renegotiation, to SONIA or other alternatives; 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."*

In further developments, the Bank of England (**BoE**) has announced a 10% "haircut add-on" for all LIBOR linked collateral from 1 October 2020, rising to 40% from 1 June 2021 and 100% from 31 December 2021. This is intended to boost the transition to their preferred RFR, Sterling Overnight Index Average (**SONIA**). SONIA, as detailed in our previous update, is an average of the interest rates that banks have paid to borrow sterling from other financial institutions on the previous day. Whilst SONIA is the preferred LIBOR replacement for sterling, there are other RFR alternatives available, with Secured Overnight Financing Rate being prevalent for US Dollars. It is recommended that any existing LIBOR arrangements that continue past 2021 will either need to (1) be converted to an alternative RFR or (2) include robust fall-back provisions in the contract. The first of the two options seems to be the preferred, long term solution as there are questions around the sustainability of the existing LMA fall-back provisions. Therefore, it is crucial that borrowers (and lenders) begin to establish their LIBOR exposures and ensure a plan is in place to manage the imminent changes.

SONIA-based bilateral loans have already been issued to National Express, SSE, Kennedy Wilson Europe Real Estate II and ABP, using the compounded in arrears methodology with a five business day lag. Indeed, on 20 May 2020, the LMA announced that it had published a list of loans to date that reference RFR. The list is based on publicly available information and seeks to raise awareness of RFR referencing loans. Whilst the list is not a fully comprehensive list of all market transactions referencing RFRs, it is hoped that publishing such a list (which will be updated from time to time to reflect new transactions) will help to drive momentum, transparency and the development of conventions for RFRs in the loan market.

The BoE is determined to support the transition to SONIA, recently announcing that it intends to publish a compounded index for the new benchmark from July 2020. This index is hoped to simplify the calculation, reduce uncertainty and increase flexibility (as it will be publically available). This means that borrowers should be able to use the index to calculate the compounded rate for certain products. The BoE is also considering publishing a set of compounded SONIA Period Averages but this is subject to responses received to their discussion paper. In a speech given by Andrew Hauser, Executive Director for Markets at the BoE on 26 February 2020, he said "*these initiatives* (the "haircut" and compounded index) *are aimed at turbo-charging sterling transition, helping the market deliver against its commitment to transition away from LIBOR and further de-risking sterling markets*".

In terms of documenting loans, unless adopting an RFR at issuance, loan agreements referencing LIBOR would need to be amended to refer to a replacement rate. The Loan Market Association has issued consultation drafts of 'reference rate selection agreements', which seek to streamline this process by adopting of a framework agreement. With this approach, the parties agree commercial terms for the selection of the applicable RFR and then authorise the agent and the obligors to make the requisite amendments to the facility documentation.

Some parties are seeking to build in their own bespoke mechanisms to switch to RFRs (recently included in Shell and BAT financings) which cater for systems developments. As mentioned above, the LMA is also looking at template wording for such switch mechanisms.

Our Finance team is working with clients on regulatory aspects, risk analysis and repapering. We also have developed templates for new SONIA lending which we see gradually increasing in several markets now. For further information on the variety of ways we can support clients, please take a look at the following pages on our website:

- IBOR transition – ways in which we can support clients
- IBOR transition - brochure

To conclude, this year remains crucial for the LIBOR transition and so if you have any questions around the impact of it and if there is anything that we can do to assist with your management of it please do not hesitate to get in touch with your usual AG contact or one of the lawyers listed below.

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