

Transition from LIBOR in the loan market LMA Webinar Update Jan '20

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Agenda

- Where are we now on transitioning from LIBOR?
- Current ‘loan market’ transition issues
 - Don’t wait for forward-looking RFR Term Rates
 - Progressing RFR Compounded in Arrears
 - Spread Adjustment
 - Loan Documentation
- What should market participants be doing?
 - Key Messages
- “Live” Q&A

Where are we now on Transitioning from LIBOR?

Where are we now?

LIBOR will be replaced by Risk Free Rates (“RFRs”)

Background

Publication of LIBOR is expected to be discontinued at the end of 2021 (a view regularly reinforced by market regulators e.g. FCA)

New Risk Free Rates (“RFRs”) such as SONIA/ SOFR are overnight nearly risk-free reference rates based solely on real transactions

Other markets are progressing transition to RFRs (e.g. OIS, FRNs) where there is increasing liquidity; loan market now needs to accelerate transition to RFRs

Forward-looking Term Rates are not certain and may only have a limited use case so other alternatives need to be progressed

To reduce systemic risk in 2021, market regulators are rightly expecting markets to make significant progress in 2020 – e.g. target of no new £ LIBOR issuance from end Q3 2020

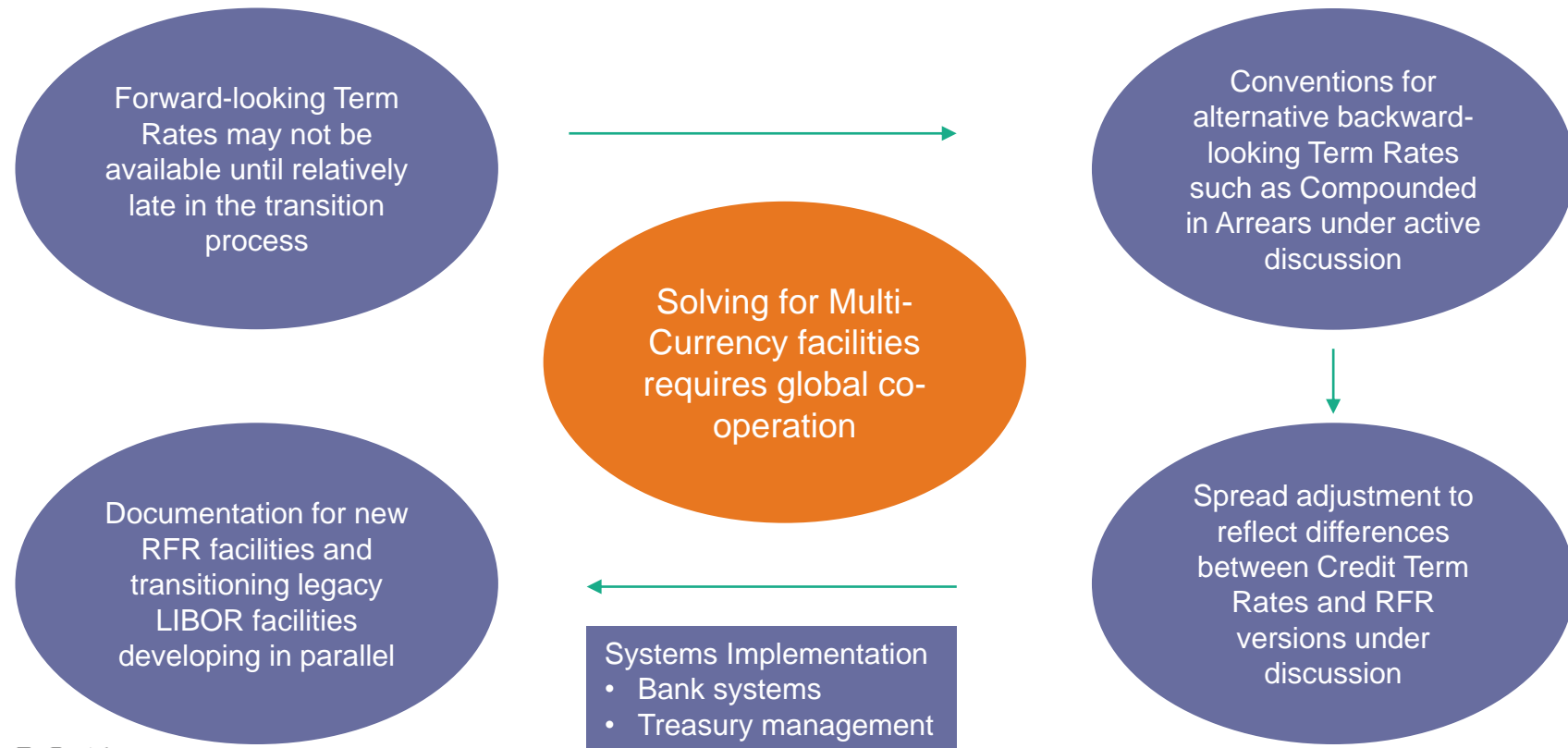
Ibor reform differs across currency

Overnight Risk-Free Rates (“RFRs”) developed in the LIBOR currencies:

| Currency | Risk Free Rate | RFR Term Rate | Credit Term Rate | Secured ? | Published |
|-------------------|--|---------------|------------------|-----------|----------------------------|
| Sterling (£) | SONIA (Sterling Overnight Index Average) | Q3 20? | N/A | N | 09:00 GMT T+1 |
| Euro (€) | €STR (Euro Short-Term Rate) <i>Live 2 October 2019</i> | TBD | EURIBOR | N | 08:00 CET T+1 |
| US Dollar (\$) | SOFR (Secured Overnight Financing Rate) <i>Live 3 April 2018</i> | End- 21? | N/A | Y | 08:00 ET T+1 |
| Swiss Franc (CHF) | SARON (Swiss Average Rate Overnight) <i>Replaced TOIS December 2017</i> | N/A | N/A | Y | 12:00, 16:00 and 18:00 CET |
| Japanese Yen (¥) | TONAR (Tokyo Overnight Average Rate) | Mid- 21? | TIBOR | N | 10:00 JST T+1 |

Current Loan Market Transition Issues

Use of RFRs – current issues in the loan market



Don't wait for forward-looking term rates

Forward-looking RFR Term Rates are not expected in the short/medium term

Don't Wait

Forward-looking RFR Term Rates would be the closest proxy to LIBOR for the loan market from an operational perspective but are not expected in short/medium term

Not all jurisdictions are progressing forward-looking RFR Term Rates (e.g. CHF); Note: Euribor will continue as a Credit Term Rate for the moment

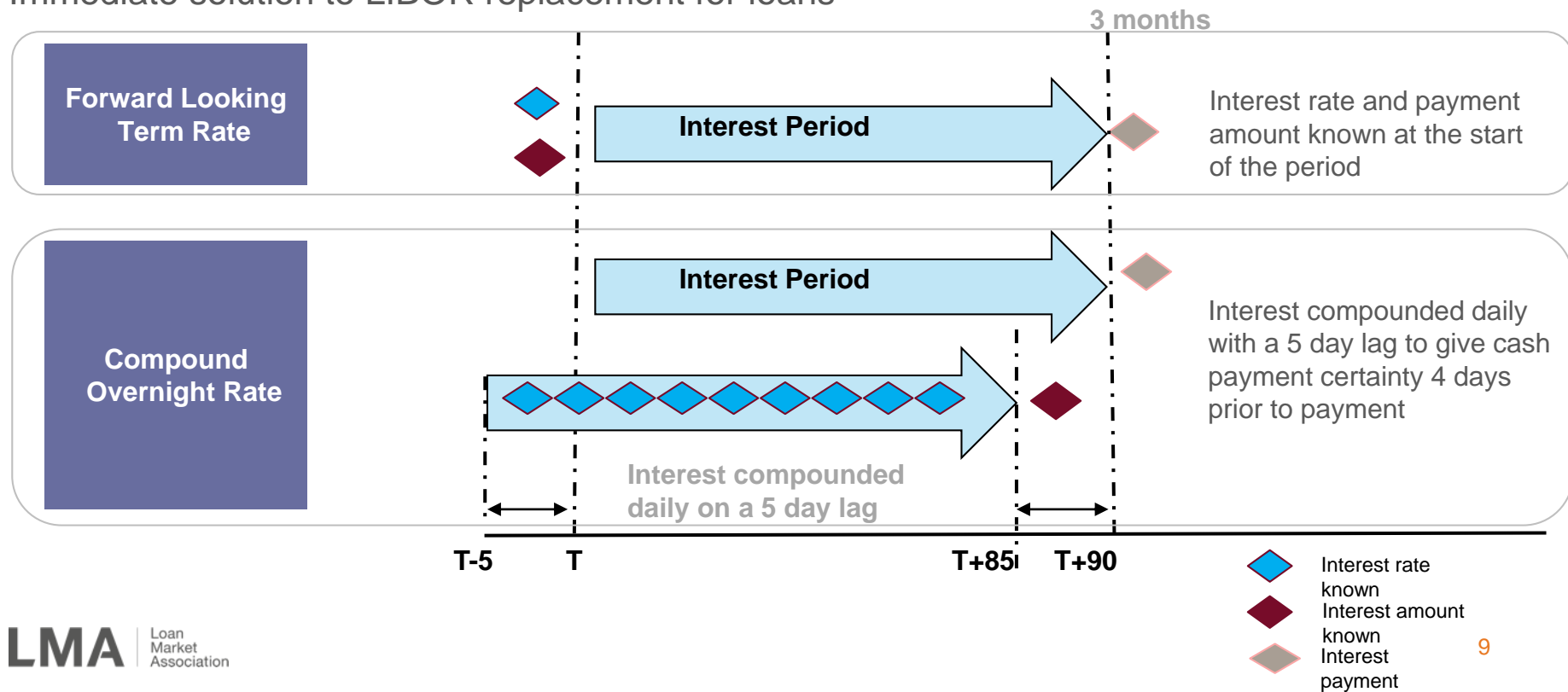
Timeline for Forward-looking RFR Term Rates in a number of key currencies (e.g. USD, GBP) is uncertain and cannot be relied upon through the transition process

Continued discussion in some jurisdictions on the specific use case for forward-looking RFR Term Rates

CONCLUSION – planning assumptions should not be built around forward-looking RFR Term Rates as a base case

Compounded overnight rates offer a solution

Whilst more complex and backward-looking, Compounded in Arrears appears most likely Immediate solution to LIBOR replacement for loans



Progressing RFR compounded in arrears

In short term, conventions for Compounded in Arrears RFR Term Rates is a priority

Action Required

Standardising production of Compounded in Arrears rates together with agreed loan market conventions key to encourage usage and transition from LIBOR

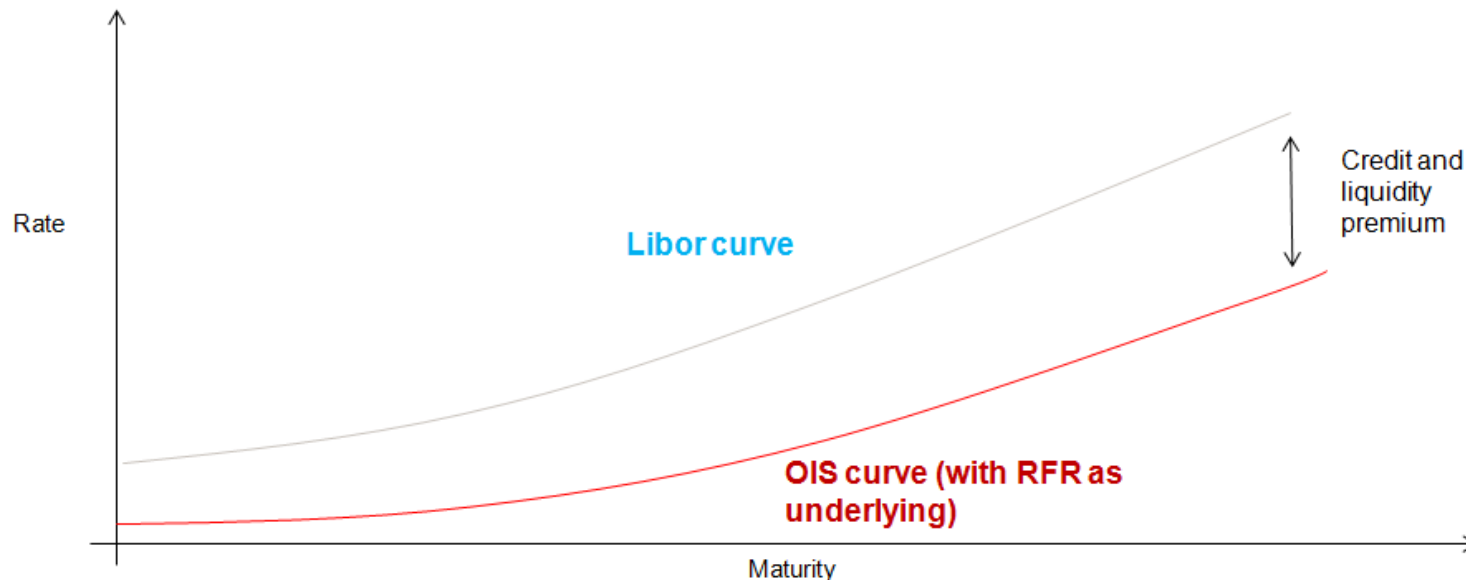
Key tasks for the loan market include finalising compounding methodology/conventions, systems' provider readiness to facilitate loan operations and borrower engagement

Loan facilities based on Compounded in Arrears have been completed for borrowers but conventions need to be agreed more broadly (rate v balance, lag v shift, rounding etc.)

Federal Reserve Bank of NY has been consulting on calculation methodology and conventions for compound averages for SOFR; need for index/calculators?

CONCLUSION – loan markets encouraged to engage actively on compounding conventions and to prepare operationally for Compound in Arrears loans

Differences between term RFRs and LIBOR



Source: Bank of England

- Term benchmarks: In a similar way to LIBOR, RFR Term Rates (e.g. compound in arrears) should compensate lenders for the time value of money; However,
- No credit premium: LIBOR includes term bank credit risk; RFRs are near risk-free
- No liquidity premium: LIBOR will include the premium paid on longer-dated funds; RFRs based on overnight rates do not include a premium for term

Approach to “spread adjustment” to be determined

To reflect differences between RFRs and LIBOR, an appropriate spread adjustment or alternative approach would be needed – transparent & market-accepted

Market to respond

Spread adjustment reflects differences between RFR & LIBOR for fall-backs and transition (spread element only - RFR-derived rates should include term structure)

Consultations in derivatives market have considered spread adjustment between RFR and LIBOR; decided on historical median approach

Cash markets are/will be consulted on credit adjustment spread methodologies, initially for fallbacks

Credit spread adjustment likely to be a set figure applicable for remainder of life of transaction (set figure may vary with tenor); dynamic spreads largely ruled out

ENGAGE – loan market participants encouraged to respond to cash market consultations on credit spread methodologies

Documentation developing in parallel

LMA Exposure Drafts of SONIA- & SOFR- based Risk-Free Rate Facility Agreements

**Please
respond**

Published in Sept 2019, LMA Facility Agreement Exposure Drafts & Commentary highlight key structuring issues for RFR facilities

Exposure Drafts based on compounded average of RFR calculated on an in arrear basis over an observation period

Exposure Drafts aim to stimulate feedback/discussion on key issues to help encourage further market development & borrower adoption

RFR facilities will need to work operationally for the loan market (including prepayments, loan agency, distribution of interest, notices, secondary trading etc.)

Documentation is also seeking to address fallbacks with a view to mitigating overall transition risk & maximising efficiency

Documentation developing in parallel

LMA Exposure Draft Reference Rate Selection Agreement

Legacy
LIBOR
loans and
new LIBOR
deals

Published in Oct 2019, LMA Reference Rate Selection Agreement for use in relation to legacy transactions transitioning from LIBOR to RFRs

Works in conjunction with the Exposure Draft RFR Facility Agreements

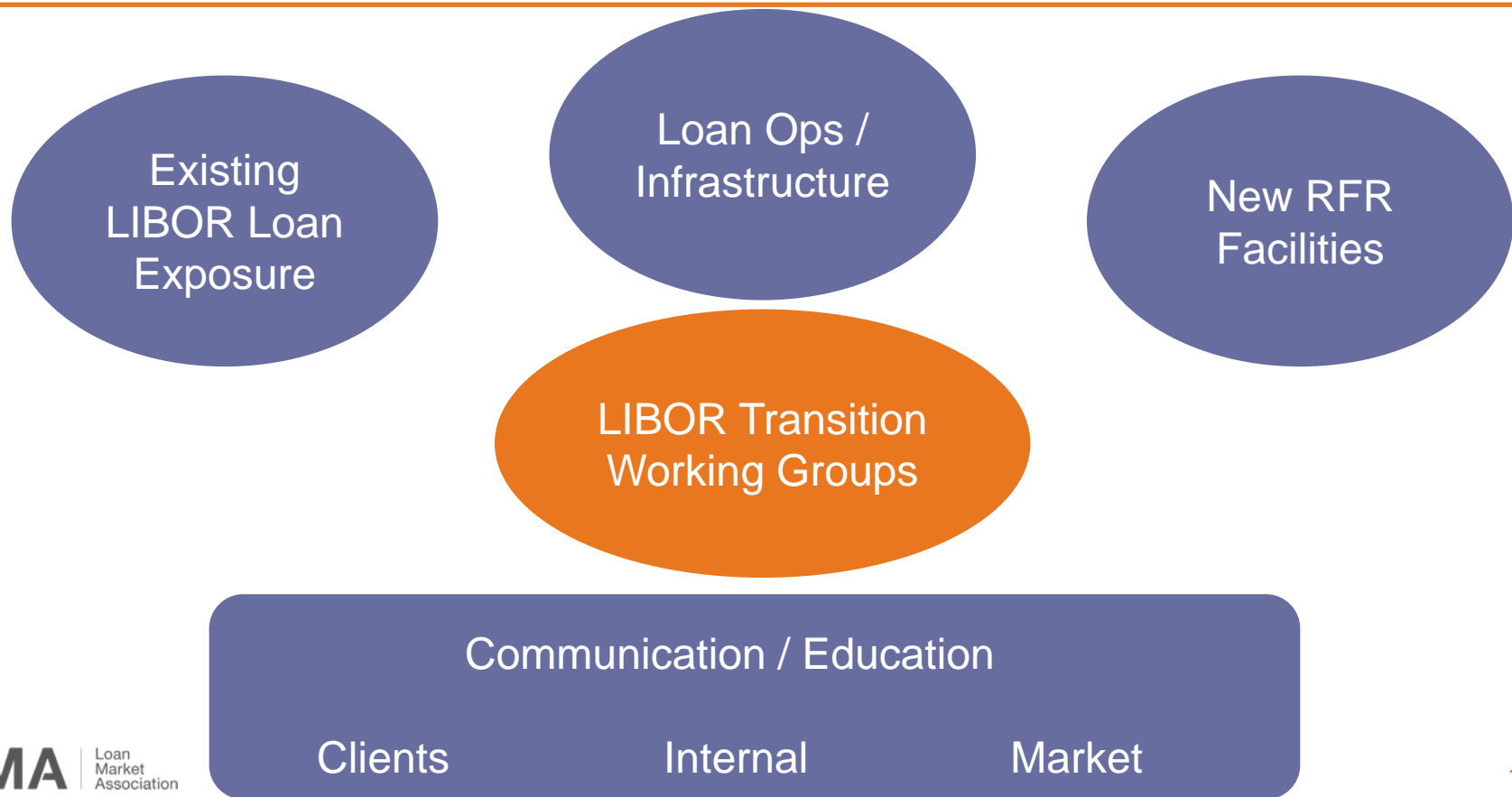
No protocol system for amendments (such as that operated by ISDA), so loans require individual amendment. Exposure draft tries to streamline the process

Exposure Draft aims to stimulate feedback/discussion and maximise efficiency

The LMA Replacement of Screen Rate Clause vs hardwired approach

What should Loan Market Participants be doing?

Action is required – all market participants



Practical steps – existing LIBOR loan exposures

- Audit of legacy LIBOR loans/transition impact
 - Scope and scale of issue
 - Fall-backs/options
 - Client engagement
- Tough Legacy?
- How to prepare for transition in LIBOR facilities being written today?
 - Replacement of Screen Rate clause
 - Fallback provisions
- When to stop issuing new LIBOR loans?
 - Regulatory pressure
 - Any risks?

Practical steps – loan operations/infrastructure

- Systems capability to offer RFR loans
 - Loans systems providers developing RFR capability
 - Banks would need to implement systems development
 - Timing to upgrade/incorporate new modules
- Understand conventions (across currencies)
 - Test understanding of issues/market discussion
 - Feed into consultations/engage with working groups & LMA
- Operational readiness?
 - Wider understanding of managing RFR facilities within your firm
 - Dual running LIBOR/EURIBOR & RFR facilities?
 - Capability/implications of being facility agent?

Practical steps – new RFR facilities

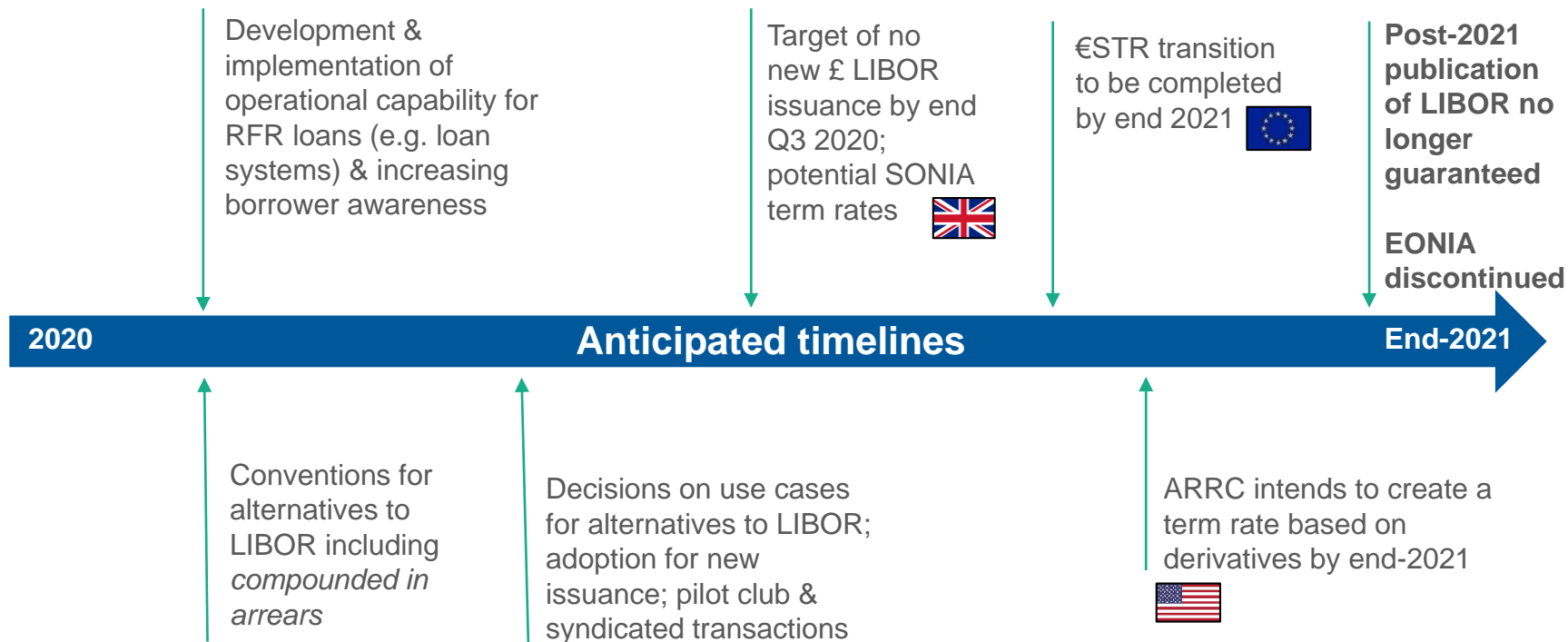
- New RFR Facilities are being completed
 - Pilot/test facilities – working through issues
 - Conventions & systems should rapidly evolve
 - Borrowers want to understand more and engage
 - Club deals/syndicated facilities are next step
- Now is the time to be more involved – market is evolving rapidly
 - Key discussions are taking place within Working Groups
 - Track the latest developments – LMA LIBOR Microsite
 - Provide feedback to ensure your voice is heard
- Broader market education
 - Client awareness across the corporate spectrum
 - Specific sector or product issues (e.g. trade finance)
 - Spreading the message/leading the market

Key Messages

Key messages – Do not ignore!

- Transition from LIBOR is happening
 - RFR facilities are being completed
 - Loan systems development should be ready
 - Conventions are being agreed
- Regulators are very focused on transition
- Banks need to get ahead of the issue
 - Operational readiness for new RFR facilities
 - Preparedness on legacy facilities/fall-back arrangements
 - Engage with clients & internal stakeholders on transition
- 2020 is the critical year

Important milestones through 2020



LMA here to support LIBOR transition

- LMA interaction with regulators, national working groups and other trade associations
 - Sterling, Euro and Swiss RFR working groups
 - Joint loans group
 - Joint trade association monthly meetings (minutes published on the website)
- Education
 - LIBOR events
 - Guides
 - Newsletter articles
- LIBOR Microsite
- Documentation



Live Q&A Session

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