Minutes of LIBOR Trade Association Working Party Meeting

held on 24 March 2021

Present:

ACT
AFME
ICMA
ICMSA
JSLA
LMA
LSTA
SIFMA
UK Finance

1. Introduction

The purpose of the meeting was for the trade associations to provide updates on any developments in respect of LIBOR transition since the last meeting.

2. ACT update

The ACT noted that it is busy preparing for the upcoming deadline set by the Working Group on Sterling Risk-Free Rates (**£RFRWG**) for no new sterling LIBOR lending by end Q1 2021 and working through the announcement by the UK Financial Conduct Authority (**FCA**) on 5 March 2021 on the future cessation and loss of representativeness of all LIBOR settings after end-2021.

The ACT continues to do a lot of work on LIBOR outreach in the market. The ACT is working with UK Finance on outreach to SMEs and corporate associations and also hosted a corporate forum on 12 March 2021 which received over 100 registrations and was attended by roughly 50 corporates. ACT noted from the conversations at the forum that whilst banks in the sterling market are increasingly talking to borrowers about the transition, the message remains fragmented (with some banks opting for a fallback approach whereas others are opting for active transition). Corporates were also focused on non-financial market challenges of the transition, including commercial contracts and tax treatment (i.e. base erosion and profit sharing (**BEPS**) schemes and other related intercompany pricing and accounting issues). Separately, the ACT is increasingly engaging on international platforms, for example, at corporate forums in Nigeria and Uganda where LIBOR awareness is picking up. The ACT has also been invited to participate in a non-financial corporates working group set up by the ARRC.

The Working Party discussed the announcements made during the US Alternative Reference Rates Committee (**ARRC**) SOFR symposium on 22 March 2021, particularly in relation to the delay to a SOFR term rate and the ARRC focus on using SOFR in advance rates as an alternative. The ACT noted that it has not seen the use of compounded in advance structures in the sterling market and is hearing from borrowers that the SOFR in advance methodology may not work well in the wider loan market and there could be market fragmentation as a result. The LSTA noted that it is also seeing this issue arise and continues to engage with the ARRC and hears that the SOFR in advance rate is primarily expected from corporates as an alternative to a term SOFR rate.

The LMA noted that term rates will likely be necessary for certain products however, the market still needs to think through the appropriate fallbacks for these, as well as potential alternatives for those currencies where term rates are not expected to be available in time for milestones to cease the end of LIBOR ending.

3. AFME update

AFME noted that it has responded to the HM Treasury consultation on supporting the wind-down of critical benchmarks, which closed on 15 March 2021. The AFME position supported the ICMA response.

Regarding SOFR compounded in advance, AFME noted that members had expressed concern on the workability of this methodology and the market fragmentation this could cause. SIFMA noted that the SOFR compounded in advance methodology is being favoured in the US as knowing the rate in advance is key and it had been used by certain entities, and the US dollar asset-backed securitisation market could also be headed towards SOFR compounded in advance (the ARRC subsequently published a white paper on this).

SIFMA also noted that this methodology is operationally easier to navigate as it can be used in existing infrastructure, whereas compounded in arrear calculations require greater change to current systems.

The LMA noted that this is an interesting development, particularly as it has explored the use of an RFR compounded in advance rate within the £RFR Loans Sub-Group, both from a borrower and bank perspective, and this methodology was rejected by both borrowers and lenders. The LMA also highlighted that the Working Group on Euro Risk Free Rates (**Euro Working Group**) only suggest using a compounded in advance method for interest periods of three months or less, as beyond this point there are difficulties with hedging. In developing markets and export finance, where six month interest periods and the use of USD LIBOR are common, the use of compounded in advance structures could cause difficulties which need to be recognised in any ARRC recommendations.

4. ICMA update

The ICMA noted that it has not heard anything on the use of compounding in advance RFRs within the bond market.

ICMA continues to consider issues around the consent solicitation process to identify what can be done to make the process more efficient between issuers and investors. In line with the £RFRWG end-Q1 deadline to identify the pool of legacy positions expiring after end-2021, ICMA is working on a paper which will consider both the feasibility of transitioning all legacy sterling LIBOR bonds to SONIA at the rate required, and the consequences for those bonds which do not transition.

Regarding bond fallbacks to LIBOR, ICMA is looking into the impact of the announcement by the FCA on 5 March 2021 on the future cessation and loss of representativeness of all LIBOR settings on so-called "type 1", "type 2" and "type 3" fallback provisions. These fallback provisions may have been triggered following the FCA announcement which ICMA are analysing in more depth. ICMA highlighted that there may also be significant variation of fallbacks within other currencies under English law which may result in slight nuances in the implications for the various fallback provisions.

Regarding consultations, ICMA noted the consultation on supporting a recommendation nominating a successor rate for legacy GBP LIBOR bonds, which ICMA contributed to the drafting of, closed on 16 March 2021. It was noted that responses had been received and there will be work on a recommendation. ICMA also responded to the HM Treasury consultation on supporting the wind-down of critical benchmarks and continues to engage with relevant UK authorities on this.

5. ICMSA update

ICMSA noted that it has submitted a detailed response to the HM Treasury consultation on supporting the wind-down of critical benchmarks to indicate their support for a broad application of safe harbours to trustees and issuers.

Regarding various fallbacks being triggered by the 5 March 2021 FCA announcement, ICMSA has observed that some of its members are beginning to see that legacy LIBOR documentation (which were signed in 2018 and 2019) are now been triggered. ICMSA noted that this means that some

US dollar legacy LIBOR contracts are expected to already transition to RFRs, well in advance of the mid-June 2023 cessation deadline for US dollar LIBOR.
Separately, ICMSA highlighted that it hears questions about negative credit adjustment spreads and, in particular, concerns on how to resolve a situation where SOFR or SONIA compounded in arrear would yield a negative rate. ICMSA noted that there seems to be increased interest in this issue as it could cause difficulties for drafting and other potential implications (for example, counterparty netting would not work as parties are unable to claim payments from clearing systems).

6. JSLA update

JSLA noted the publication, on 26 February 2021, of a fallback language example for syndicated loans, which was based on the bilateral loans wording released by the Japanese Bankers Association (**JBA**) in January 2021.

Following the FCA announcement on 5 March 2021, the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks announced that it would deepen its discussion and support on the transition based on synthetic yen LIBOR, proposed by the FCA. JSLA noted that whilst Japanese banks are preparing for this with their clients, they have also expressed strong demand for a term risk free rate, such as the Tokyo Term Risk Free Rate (**TORF**), to be available in April 2021 (note: QUICK Corp. has subsequently announced that this will be available on 26 April 2021). Following this, transition is expected to accelerate.

Regarding milestones and transition timelines, JSLA highlighted that by June 2021 there shall be no more new JPY LIBOR lending, which will help drastically reduce the number of LIBOR-linked transactions.

7. LMA update

The LMA noted that it has responded to the HM Treasury consultation on supporting the wind-down of critical benchmarks. The LMA has also been looking at the implications for LMA documentation of the FCA announcement on the future cessation and loss of representativeness of all LIBOR settings by end-2021. The LMA highlighted that it has included a briefing on its website by Clifford Chance to inform users of the impact on LMA-style loan agreements.

On the loans side, the £RFRWG published on 18 March 2021 an updated best practice guide for GBP referencing loans as well as updated supporting materials to the SONIA loan market conventions, to include a clarifying amendment on rounding conventions. The LMA highlighted that this has a knock-on implication for LMA documentation, as these reflect the SONIA loan market conventions. The LMA is therefore updating its RFR based documentation to reflect the update to the supporting materials, as well as updating its RFR exposure drafts into recommended forms. The LMA RFR documents were subsequently published as recommended forms on 30 March 2021.

Regarding education, the LMA published a series of interviews held between Kam Mahil, Senior Director – Legal at the LMA and different market participants (such as borrowers, lenders, law firms and asset managers) to get a better view of the situation on the ground on how various stakeholders are dealing with end-Q1 sterling deadlines. The LMA also continues to work closely with the Euro Working Group to develop recommendations for EURIBOR fallback rates and triggers, following the EURIBOR consultations published in November 2020.

8. LSTA update

Following the 5 March 2021 announcement by the FCA, the LSTA has been very busy on various workstreams. The LSTA highlighted that, similar to the LMA, it has been focussed on identifying the implications of the FCA announcement on loan documentation. The announcement has created some uncertainty in terms of the impact on loan documentation given the way that it was structured. In terms of the latest ARRC hardwired fallback language, the ARRC confirmed that a trigger had occurred. Whilst it is not completely clear whether a trigger has occurred in documentation not using the ARRC hardwired fallbacks, which would require agents to deliver trigger notices, the LSTA has developed a general form of notice and amendment announcing the occurrence of a general trigger event, although caveating that this does not necessarily mean that a trigger has occurred within a particular document. ICMSA noted that it is helpful that the LSTA has developed this form of notice and clarified therein that the FCA announcement does not necessarily mean that a trigger has occurred within the meaning of a specific document because it cannot advise on each individual document.

Regarding education, the LSTA continues its outreach. The LSTA noted that there is discussion in the market on credit adjustment spreads. In particular, the LSTA is seeing that the market understands rates to be low currently and therefore a 5-year historic median approach (where the difference between LIBOR and SOFR is now high) will yield a more expensive SOFR fallback by 10-15 bps. This is creating tensions for borrowers and reducing uptake of early opt-in triggers. The LSTA is also seeing that borrowers are uninclined to pay the 5-year historic median credit adjustment spread as they see it as uneconomic on a spot basis. The LSTA highlighted that although the spot-basis result is less favourable for borrowers, the credit adjustment spread is lower and more economic when used over five-plus years.

On the documentation side, the LSTA highlighted that CLOs will look to the LSTA for working out the recommended fallback rates. In this respect, the LSTA noted that the ARRC has been working on an abridged hardwired fallback language for syndicated and bilateral loans which will simplify the process of identifying the RFR rate and the added credit adjustment spread, within a condensed 3-page document (note: the abridged fallback language was subsequently published on 25 March 2021).

In addition to this workstream, the LSTA is looking at what it can do to make RFR rates workable within a multi-rate context. In the US market, the issue remains that there are to be no new LIBOR originations after end-2021, however, most US dollar LIBOR tenors will only cease to be published until after mid-2023. This will mean that certain transactions will take place within a multi-rate environment as there will be fragmentation in timelines between most US dollar LIBOR settings and other LIBOR currencies which will cease to be published after end-2021. This will create operational challenges. In addition, we may notice multiple calculation methodologies arising (i.e. term RFRs, simple RFRs, compounded RFRs in arrear etc.). The LSTA is trying to educate market participants on these challenges, and will hold an educational ops series on this on 13 April 2021 which will bring together loan market specialists to discuss the future multi-rate environment.

The LSTA asked members of the Working Party how the sterling market was progressing ahead of the 31 March 2021 deadline for no new sterling LIBOR loans. ICMA noted that the bond market is on track to meet this deadline and ICMA has noticed a few small private placement transactions. The LMA noted that on the loans side it had not heard recently of particular issues, but this will remain to be seen.

The LMA noted that the market has seen a few RFR-based deals, and recently a leveraged SONIA-based deal was in the press. The LMA highlighted that it is difficult to assess progress as the market is currently quieter and market participants may be preparing their systems and deals ahead of early Q2. On the syndicated side, the message has been very clearly communicated to banks and banks are under pressure to meet the end-Q1 deadline. It would be unlikely that they do not meet this deadline given the regulatory pressure, however it is not possible to tell if this has an influence on the timing of deals.

The LMA noted that, in terms of the LSTA's observation on the credit adjustment spread, it had also heard of borrowers question the use of a historic median approach for their credit adjustment spreads as it will yield more expensive rates.

9. SIFMA update

SIFMA provided an update on tough legacy legislation in the US. Regarding federal legislation (Representative Sherman's bill), SIFMA noted no further changes since the previous Working Party meeting. The Bill continues to seek Republican sponsors and it is hoped there will be a hearing in April 2021 for the legislation to be discussed and published. US Treasury Secretary Yellen and Federal Reserve Chair Powell have mentioned their support for the legislation. Vice Chairman Quarles also noted his support for the legislation during the SOFR symposium on 22 March 2021.

Regarding state legislation, the New York Bill on tough legacy contracts has made it into Governor Cuomo's budget. The Senate and the Assembly will come together on the Bill's budget. It is hoped this process will be finalised by the end of the month by April 2021 (note: this Bill was subsequently passed in the Senate and Assembly on 24 March 2021).

10. UK Finance update

UK Finance noted that it had responded to the HM Treasury consultation on supporting the wind-down of critical benchmarks.

Regarding education, UK Finance continues to look at how it can support active transition to RFRs within the market. For instance, UK Finance continues to discuss challenges for residential mortgage customers, in particular, the issue of conduct risks. Within this context, UK Finance noted that it is looking into the implication of active transition to RFRs for tough legacy definitions. UK Finance is also working through implications on so-called 'mortgage prisoners'.

To support this workstream, UK Finance and TLT published on 10 March 2021, their Mortgage Customer LIBOR Transition FAQs to cover issues around how retail mortgage customers can work with banks and other borrowers.

11. AOB

The LMA thanked members of the Working Party for their updates. The date of the next meeting is to be set for April 2021 and minutes would be circulated.