



Finance ADVISORY ■

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Discontinuing GBR LIBOR: The Time to Act Is Now

by [James Spencer](#) and [Andrew Petersen](#)

2020 has, without doubt, provided loan market participants with a host of far-reaching issues to address in the face of the coronavirus pandemic. But whilst the coronavirus pandemic – along with all the resulting economic, financial, fiscal, political, and legal consequences and responses – continues to consume a vast amount of attention for all those in the market, now is the time for migrating from the London Interbank Offered Rate (GBR LIBOR) to a better-equipped, risk-free rate to become the focus of attention.

In a statement in response to the coronavirus pandemic on 25 March 2020, the UK's Working Group on Sterling Risk-Free Reference Rates (Working Group), Financial Conduct Authority, and Bank of England said: "The central assumption that firms cannot rely on GBR LIBOR being published after the end of 2021 has not changed and end-2021 should remain the target date for all firms to meet. The transition from GBR LIBOR remains an essential task that will strengthen the global financial system."

Whilst the number of issued loans based on the Sterling Overnight Index Average (SONIA) has increased, the reality is that the overwhelming majority of new loans being written in the UK market are still GBR LIBOR-based. For many, it's still too early in the process for lenders to be able to calculate interest on a SONIA basis, as they do not yet have appropriate systems in place to operate SONIA-based loans and therefore are not yet able to offer SONIA-based loans. This must change.

For these same reasons, most newly written GBR LIBOR-based loan agreements do not set out how the loan will be converted to SONIA, nor how interest will be calculated once converted. Reliance is being placed on the inclusion of replacement of screen rate wording in these loan agreements that simply contemplates transaction parties needing to amend their loan facilities at some point before the end of 2021. The replacement of screen rate wording is merely an acceptance that the loan agreement will need to be amended in the future and sets out an agreed process for negotiating and agreeing any necessary amendments.

Fortunately, there are industry groups that are focusing on change. In September, the Working Group issued its latest recommendations, this time in relation to the conventions for referencing compounded in arrears SONIA. Also in September, the Loan Market Association (LMA) issued its "exposure draft" facilities agreement (based on its form of multicurrency term and revolving facilities agreement) incorporating rate switch provisions based on lookback without observation shift (exposure draft).

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Working Group Recommendations

As previously highlighted by the Working Group:

- By the end of September 2020, market participants should be ready to both offer non-GBR LIBOR loan products and to include the provision of contractual conversion mechanics in new or refinanced GBR LIBOR products; and
- By the end of Q1 2021, no GBR LIBOR-based loan products should be issued with a maturity falling after the end of 2021.

Following widespread demand from sterling loan market participants and “in recognition of the urgent need for loan market participants to commence transition away from the use” of GBR LIBOR, the Working Group’s latest statement issued at the beginning of September set out in detail its recommendations on conventions for referencing compounded in arrears SONIA in the sterling loan market, along with helpful supporting slides and examples to assist market participants in better understanding how the calculations will work. In summary, the recommendations are:

- That SONIA remains the Working Group’s recommended alternative to sterling GBR LIBOR and should be implemented via a compounded in arrears methodology (the market showing a preference to compound the rate rather than the balance);
- The use of a five-banking-day “lookback without observation shift” (whereby SONIA is derived from the observation period but weighted according to the days in the interest period) while recognizing that a “lookback with observation shift” approach (weighted according to the days in the observation period, rather than the interest period) remains a viable and robust alternative;
- Interest rate floors should be applied to each daily interest rate before compounding; and
- In connection with any loan prepayments, accrued interest should be paid at the time of principal prepayment (in order to avoid unnecessary complexity in making the compounded calculations).

LMA Exposure Draft

Hot on the heels of the Working Group’s latest recommendations, the LMA issued on 11 September its exposure draft containing suggested rate switch provisions. The exposure draft follows on from the exposure drafts of the compounded SONIA term and revolving facilities agreement and the compounded SOFR term and revolving facilities agreement published by the LMA in 2019. Indeed, the rate switch provisions in the current exposure draft are based on provisions in the 2019 exposure drafts with updates to reflect input received to date by the LMA from market participants and the Working Group.

The exposure draft (which is not a recommended form and will not be finalized until the LMA receives feedback from market participants) provides a contractual framework allowing lenders to offer GBR LIBOR loan products that include contractual conversion mechanics, which, as mentioned above, the Working Group has recommended market participants are able to do by the end of Q3 2020.

The exposure draft rate switch provisions, in line with the Working Group’s most recent recommendations, adopts a five-banking-day lookback without observation shift methodology and non-cumulative compounded methodology.

A Word on Legacy Loans

Market participants shouldn't forget about and, in some respects, should perhaps prioritise tough legacy loans that have neither replacement of screen rate wording nor rate switch wording in their loan agreements. For such loans, it is likely to be harder, in a practical sense, to amend these loans, and so transaction parties should allow themselves a longer runway to amend these agreements. For existing transactions involving larger and active syndicates, amendments will prove particularly difficult to execute.

Parties also need to keep in mind then when shifting legacy loans from GBR LIBOR to SONIA, they are likely to need to incorporate a credit adjustment spread to take into account how GBR LIBOR and SONIA are fundamentally different rates – the adjustment spread being added to SONIA as part of the interest calculation post-switch to account for the credit and liquidity risk inherent in GBR LIBOR but which simply don't exist in SONIA.

Therefore, when transitioning legacy products away from GBR LIBOR, there will be a need for parties to agree a fair credit adjustment spread methodology. Following the Working Group's consultation on credit adjustment spread methodologies for fallbacks in cash products referencing GBR LIBOR, the credit adjustment spread should adopt a historical five-year median difference methodology based on the strong consensus that arose from that consultation and following the same approach being taken in the derivatives markets.

Final Comments

Both the Working Group's most recent recommendations and the LMA's exposure draft are welcome and timely developments for the loan markets. The Working Group's worked examples and supporting slides in particular provide market participants with useful tools to start updating, testing, and assessing their systems and processes to deal with the post-GBR LIBOR world and to create greater confidence in the market for lenders to start offering SONIA-based loan products and borrowers to understand what it means for them. If they haven't already, everyone in the market should consult these useful resources and begin work on preparing for transition now.

As we enter Q4 2020, the expectation and hope will be that we should expect to see a noticeable uptick in new loans being issued based on SONIA or, at the very least, being issued with appropriate rate switch provisions incorporated into loan agreements.

Alston & Bird has created an [innovative technology-assisted solution](#) to help financial institutions manage the transition risks on legacy transactions from the phase-out of LIBOR scheduled for the end of 2021. The new technology-assisted workflow is the latest initiative by Alston & Bird to help clients successfully navigate the transition from LIBOR.

In October 2019, the firm launched its [LIBOR Transition Task Force](#). A multidisciplinary group spanning several Alston & Bird practices – including structured and corporate debt finance, corporate trust, financial services, litigation, real estate finance, and consumer financial services.

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