CLIFFORD CHANCE

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Negative LIBOR – implications under syndicated lending documentation

Negative interest rate benchmarks are not unknown. The loan market first grappled with the issue in 2011 when Swiss Franc LIBOR was reported as negative in some circumstances. However, recent activity by central banks has resulted in a preponderance of negative LIBORs for Swiss Francs and negative LIBORs and EURIBORs for Euro, sparking fresh concern about the potential effect on lending arrangements. This briefing considers some of the key questions arising for Lenders and Borrowers in the syndicated loan market.

This briefing assumes that the facility agreement in question follows the recommended form of the Loan Market Association and is governed by English law.

What is the effect of a negative LIBOR (or EURIBOR) on the interest rate calculation?

The effect of a negative LIBOR will differ depending on whether the facility agreement in question contains a Zero Floor (see box *Interest rate calculation under syndicated loans* overleaf).

- ***Does contain a Zero Floor***
  The overall interest rate will be determined by adding the Zero Floor to the margin. The result will be that the interest rate will be the margin. The negative LIBOR will not have the effect of eroding the margin.
- ***Does not contain a Zero Floor***
  The overall interest rate will be determined by adding the negative LIBOR to the margin. The result will be that the interest rate will be less than the margin. The negative LIBOR will have the effect of eroding the margin.

In the absence of a Zero Floor is there an implied term to the effect that the overall interest rate will never fall below the margin?

Unlikely. English law is reluctant to imply terms in contracts, particularly where those contracts are made between sophisticated parties. The wording of the interest calculation in LMA style facility agreements is clear and there is no obvious gap that needs completing. Accordingly it is unlikely that a court would imply such a term.

In the absence of a Zero Floor could the overall interest rate be negative?

Yes. Adding the negative LIBOR to the margin could, depending on the figures involved, result in a negative interest rate under the facility.

Does an overall negative interest rate require the Lenders to make a payment to the Borrower?

In general terms, no. If the overall interest rate itself is negative there will

Key issues

- A negative LIBOR will reduce the margin payable under a facility agreement unless a zero LIBOR floor is included
- If there is no zero LIBOR floor the overall interest rate under the facility agreement could itself be negative. However, in the ordinary course this would not require the Lenders to make a payment to the Borrower
- A negative LIBOR will not, in itself, automatically trigger the market disruption provisions but might well create the circumstances in which they could be invoked by Lenders

be no requirement in the ordinary course for the Lenders to pay the Borrower. LMA style facility agreements provide only for the payment of interest by the Borrower to the Lenders and it is unlikely that a court would interpret the relevant provisions (or otherwise imply a term) to mean that the Lenders pay the absolute value of a negative interest rate to the Borrower.

However, it is important to note that transaction specific terms or circumstances might lead to a different conclusion and the parties would need to take into account all relevant circumstances and connected transactions including hedging.

Should I include a Zero Floor in future transactions?

The inclusion of a Zero Floor will be a function of the commercial dynamics of the transaction. If a Lender's imperative is to prevent potential erosion of its margin as a result of a negative LIBOR then inclusion of a Zero Floor is likely to be a high priority.

However, other factors may militate against the inclusion of a Zero Floor (for example, if the transaction involves a corresponding hedging product the inclusion of a Zero Floor could result in mismatches with rates payable under the derivative). Such factors may outweigh the benefits of margin protection in some cases. Of course the borrower's perspective in any negotiation will also be critical.

Does a negative LIBOR mean that the market disruption provisions will be triggered?

A negative LIBOR will not in itself trigger the market disruption mechanic. The mechanic applies only if a specified proportion of Lenders (normally between 30-50 per cent by value of participation) notify the facility agent that their cost of funding the loan exceeds the applicable LIBOR (or EURIBOR). Although as a matter of fact a number of Lenders might find that their cost of funding the loan exceeds a negative LIBOR (or any Zero Floor) the market disruption provisions will apply only if the required proportion of Lenders choose to invoke those provisions by notifying the facility agent that this is the case.

Interest rate calculation under syndicated loans

The interest rate under syndicated loans is typically expressed as the sum of:

- LIBOR (or EURIBOR) (determined in the first instance by reference to an official screen rate); and
- the specified margin.

The calculation may incorporate wording which provides that the applicable LIBOR (or EURIBOR) shall never be less than zero. (The Loan Market Association released a recommended form of such wording in 2011.) We refer to this as a "**Zero Floor**".

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