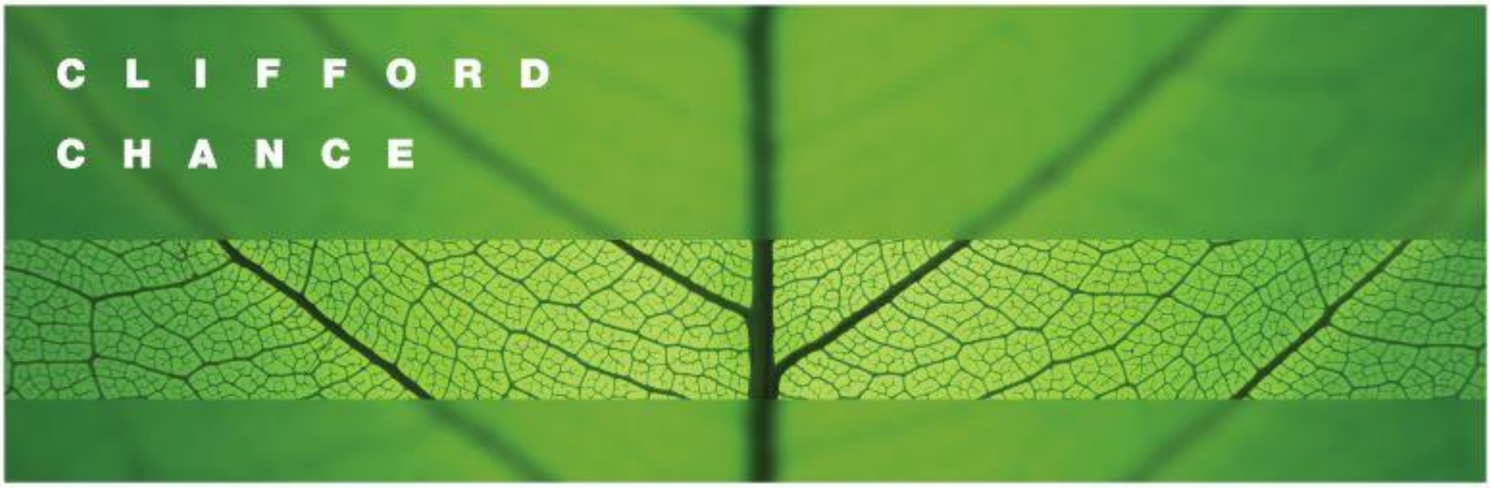


LIBOR TRANSITIONING – THE IMPACT ON FACILITY AGENTS

With LIBOR due to be phased out by the end of 2021, loan agents ("agents") need to understand how this will affect their business and how to best prepare themselves for such an unprecedented change. This briefing focuses on the impact of LIBOR transitioning for agents – both from the perspective of their own position and as representatives for lenders.

Key issues

- Agents ought to prepare themselves for the phasing out of LIBOR at the end of 2021.
- Agents will want to consider their current obligations under existing fallback provisions and their engagement strategy with their commercial counterparts.
- Reference Rate Selection Agreements should ease the transition burden, but agents will want to ensure their associated powers are commensurate with their expectations of the role.
- As 2021 draws closer, agents will need to assess the timing implications of remaining LIBOR legacy transactions.

Ever since the FCA signalled that it would cease to compel panel banks to make LIBOR submissions from the end of 2021, it has encouraged an active transition away from LIBOR rates. The LMA supported this objective by publishing its draft syndicated Reference Rate Selection Agreement in order to streamline the amendment process by empowering agents to document alternative reference rates and consequential changes on behalf of and in accordance with the agreement of lenders. Regardless of whether industry consensus is reached on replacement reference rates, agents are likely to remain at the forefront of any transition strategy, particularly as commercial parties assess transactions with a maturity after the end of 2021 to determine whether amendments are needed or fallback provisions are fit for purpose. In particular, some agents may choose to take pre-emptive steps to support and administer the transition process, for themselves and their commercial counterparts.

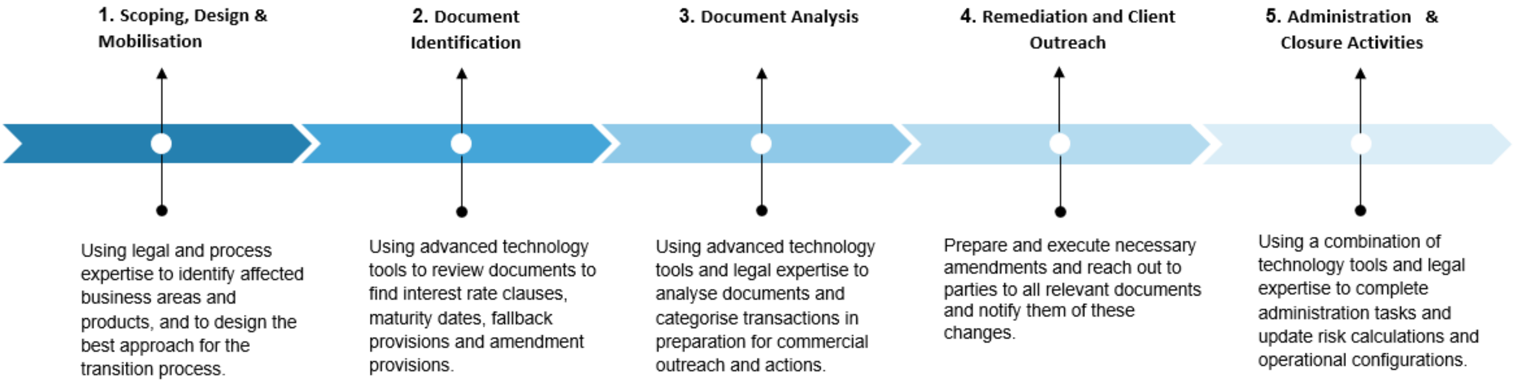
For more information on alternative reference rates, please see our website here.

In this briefing we explore how a LIBOR replacement project may be structured. While this briefing focuses on agents, many of the themes will be relevant to other reference rates and to other counterparties with an interest in lending transactions.

DILIGENCE AND PROJECT MANAGEMENT

One of the key challenges in identifying the impact of LIBOR is the sheer volume of transactions that could be affected. Any large scale diligence project will need to be carefully structured and while legal technology can assist with document management, categorisation, and key term identification, there will inevitably be many transactions that will need to be considered on their own terms and in their own context.

Parties will need to assess their exposure to LIBOR to determine whether there is a need for an amendment, or, where there is a fallback provision, how it will operate. Below we set out a basic model of how a LIBOR transition project could be managed and the potential steps involved.



Leaving aside cost, one of the main concerns for those affected is the administrative burden associated with transitioning. An effective project strategy will be pivotal in responding to the varying degrees of complexity involved in a timely manner.

ENGAGEMENT

Agents' duties under loan documentation are typically described as being 'mechanical and administrative in nature' with the result that agents would commonly be expected to adopt a position that is reactive to that taken by borrowers or lenders. In practice, an agent may be more proactive if it fulfils other commercial roles on a transaction (in particular where it also has a commitment to lend). An agent who is also a lender on a given transaction may consider that it is commercially incentivised to share information about transitioning prepared by other lenders or to drive the transition strategy in a way that independent agents might not be. However, those agents will need to think carefully about designing and implementing internal policies to ensure they confine themselves to their agency remit of administering the process. Agents who are less commercially involved may, understandably, wait for a formal amendment request (and instructions) and seek to rely on typical documentary provisions to recoup the full extent of their costs. Typical documentation will allow agents to refrain from acting unless such costs can be reasonably assured to them but there may be commercial pressure on agents to act swiftly.

FALLBACK PROVISIONS

Original fallback provisions sought to address temporary unavailability of LIBOR, with more recent documentation often providing more robust forms of fallback provision to address alternative reference rates and alternative means of calculating the rate of interest. Most loan fallback provisions ultimately revert to a calculation of cost of funds (where the definition and process for calculation may vary) but other fallback options may be present in documentation including rates identified by a reference bank poll, fixed rates or in rare cases, central bank interest rates.

Should the fallback wording become operative, the agent may need to request and collate reference bank quotes or cost of funds information obtained from the lenders. It would normally be possible for an agent to request instructions from lenders as to whether, and in what manner, it should exercise or refrain from exercising any such power or authority where the fallback is unclear or gives rise to uncertainties. Agents may also need to undertake the exercise of interpolation and/or calculations such as the weighted average of the lenders' cost of funds. Calculations for a single lender in a bilateral loan may be more straightforward but in a syndicated context, this task could be particularly burdensome. As the volume of administration increases, the ability to action multiple requests may prove challenging at best.

Earlier fallback provisions that were common place before LIBOR discontinuation was contemplated, such as a calculation of cost of funds, were never designed to be a permanent solution for LIBOR discontinuation. The associated burden for lenders and agents may therefore incentivise parties to want to amend the documentation in accordance with the amendment provisions in the documents.

AMENDMENTS

There is an obvious need for parties to amend existing documentation to ensure that floating rate interest can still be calculated post-LIBOR where this is not already expressly covered in the documentation. Parties may also choose to make amendments, for instance in the case of "zombie" LIBOR, where the rate continues to be published but no longer reflects the intended economic reality of a given transaction. It is possible that different lenders and obligors may take an opposing view as to what amendments should be made. Even where consensus is reached, agents will have an understandable interest in ensuring the replacement rates are capable of being calculated in practice and that their costs will be covered as part of the process.

The current LMA facility agreement templates contain a special amendment provision relating to replacement of the reference rate. This amendment provision requires the consent of a defined majority of lenders and the obligors, and stipulates that if a lender fails to respond to such a request for consent, that lender's commitment will be disregarded for the purposes of calculating the necessary percentage of lenders' consent. This is particularly helpful for amending transactions as it reduces the need to have all lenders in agreement. However, as legacy transactions may not follow this form (or may follow an earlier version, which contains a less comprehensive form of the replacement screen rate provision), parties will need to assess and operate in accordance with transaction-specific requirements. A change to the reference rate is likely to require either the consent of all lenders or the consent of the majority lenders, in addition to the obligors.

For those transactions entered into on LMA terms, the LMA's Reference Rate Selection Agreement contemplates a two-step amendment process (particularly for transactions involving a large syndicate where it may not be straightforward to seek the consent and execution of all parties to every amendment agreement). The first step is the reference rate selection by which parties will agree on the replacement reference rate and the second step involves the agent and the obligors deciding on the necessary amendments to effect the selections made substantially in line with LMA drafting.

The main purpose of the Reference Rate Selection Agreement is to increase awareness of documentary mechanics and help streamline the transition as the end of 2021 draws closer. This is seen as a welcome move by the market to socialise the basic commercial terms for the selection of alternate reference rates with a view to facilitating the process of implementation. The draft does however contemplate a level of discretion for agents to effect the amendments (and take associated actions) which agents will want to assess in the context of their otherwise 'mechanical' duties.

Agents are typically empowered to effect amendments agreed to by the lenders and those are expressed to be binding on all parties. Whilst the two-stage process replicates this arrangement by ensuring that lenders retain decision-making power over what the rate will be and leaves the administration of implementing those amendments to the agent, certain aspects of the process still need to be decided upon. Agents should consider the implications for their role, particularly in terms of cost allocation and who will be responsible for proposing commercial terms. It is likely that the rate will be driven by market consensus but there will be terms to be agreed around documentation and responsibility for opinion coverage and other conditions precedent.

As consensus builds around the use of the Sterling Overnight Index Average or "SONIA" (see the LMA's recent exposure drafts of facilities containing SONIA interest rate provisions), the expectation is that the associated framework to effect the amendments could also become standardised. This will not alleviate the need for allocating responsibility for the implementation, but may reduce variance from transaction to transaction, particularly for those undertaken on LMA standard terms.

Where there are fewer counterparties, those participants may decide to bypass the reference rate selection agreement and have all parties enter into an amendment agreement thereby approving the form and substance of the amendments.

CONCLUSION

A market-driven change of this magnitude inevitably requires a coordinated response by participants. It will be as beneficial for obligors and lenders to consider their engagement strategy with their agents as it is for agents to consider their own position given the impact on their business and administration – whether through interacting with finance parties, considering fallbacks, agreeing rate selection, tracking consents and/or negotiating amendment agreements. It is likely that agents cannot afford to be completely reactive to counterparties approaching them with potential solutions and even where a solution is advanced, agents will want to be prepared for the effect on their resources and for possible consequences in terms of internal governance, costs and execution risk.

With the Working Group on Sterling Risk-Free Reference Rates recently publishing their 2020 roadmap, momentum is increasing for participants to be ready for LIBOR discontinuation. Regulated participants will have to engage in the process to avoid sanction and this should help focus the market so as to avoid participants being seen as outliers.

CONTACTS

Louise Keary
Partner

T +44 207006 1249
E louise.keary@cliffordchance.com

Bruce Kahl
Partner

T +44 207006 2419
E bruce.kahl@cliffordchance.com

Stuart Mason
Senior Associate

T +44 207006 4291
E stuart.mason@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance 2020

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.