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FCA ANNOUNCEMENT ON THE END OF LIBOR AND IMPLICATIONS FOR LOAN DOCUMENTATION

In light of the FCA's announcement (the "**Announcement**") on the future cessation and loss of representativeness of the LIBOR benchmarks, you may be wondering what this means for loan transactions. In this briefing we examine the formal confirmation of the end of LIBOR and the documentary implications for English law loan transactions

(1) END OF LIBOR AND CESSATION OF ITS USE FOR TRANSACTIONS

The announcement confirms that all LIBOR settings for all currencies will in fact either cease or no longer be representative immediately after the dates set out to the right. Although this position has been heralded over the last few years, the announcement represents formal confirmation of the cessation of the LIBOR benchmark. The various currency and jurisdiction specific working groups have emphasised the need for parties to transition away from the use of LIBOR and this announcement should catalyse the transition not least as it was made with the awareness that certain contractual triggers for the application of fallbacks or other contractual provisions will be activated. Further, parties will be mindful of the forthcoming targets of certain working groups that issuance of new LIBOR transactions should cease – the first being that of the Working Group on Sterling Risk-Free Reference Rates ("**£RFR Working Group**") whose 2021 priorities and roadmap confirms their recommendation that by the end of Q1 2021, there is a cessation in the initiation of new GBP LIBOR-linked loans that mature after the end of 2021. In addition, the £RFR Working Group emphasises the need for market participants to review their existing portfolios of contracts expiring after the end of 2021 and to ensure that where transactions can be actively converted away from the use of sterling LIBOR, active conversion is progressed "*where viable*" such that it is completed by the end of Q3 2021.

Although the FCA states in the Announcement that it is considering using its proposed new powers to require continued publication of LIBOR on a synthetic basis (subject to the enactment of the Financial Services Bill) to enable "tough legacy" contracts which cannot be amended to continue, it remains to be seen to what extent this will be applicable to loan transactions. It may cover only those transactions which genuinely cannot be renegotiated or amended: potentially a very small pool of loan agreements and so loan market participants should not assume they will be able to make use of this.

The FCA Announcement

The FCA has confirmed that the publication of:

- all seven euro LIBOR settings, all seven Swiss franc LIBOR settings, overnight, one-week, 2-month and 12-month sterling LIBOR, spot next, one week, 2-month and 12-month Japanese yen LIBOR and one-week and 2-month US dollar LIBOR will permanently cease immediately after 31 December 2021; and
- the overnight and 12-month US dollar LIBOR settings will permanently cease immediately after 30 June 2023.

For the remaining LIBOR rates and settings, the FCA announced that:

- the 1-month, 3-month and 6-month Japanese yen LIBOR settings and the 1-month, 3-month and 6-month sterling LIBOR settings will cease to be provided or, subject to consultation by the FCA, will be provided but will be determined by reference to an alternative "synthetic" methodology immediately after 31 December 2021;
- publication of the 1-month, 3-month and 6-month Japanese yen LIBOR settings will in any event cease after 30 December 2022; and
- the 1-month, 3-month and 6-month US dollar LIBOR settings will cease to be provided or, subject to consultation by the FCA, will be provided but will be determined on an alternative "synthetic" basis immediately after June 30, 2023.

The FCA confirmed that if such settings are determined by reference to an alternative methodology, they will no longer be representative of the underlying market and economic reality they are intended to measure and that representativeness will not be restored.

Consultation is expected later in 2021 on which legacy uses of synthetic LIBOR might be permitted.

(2) DOCUMENTARY IMPLICATIONS

Whether the Announcement will have any impact under English law, LMA-style loan agreements will depend on their terms. The following are some implications that should be considered but readers will need to review the exact terms of their own documentation to determine the full impact.

Loan Agreements with no specific provisions to address transition away from LIBOR

These agreements typically contain fallbacks to other LIBOR-based rates and/or cost of funds. The Announcement should have no immediate impact under these documents – the fallbacks are likely to be triggered where "*no Screen Rate is available for LIBOR*" - which will not occur before the end of 2021, depending on the currency concerned. Parties will, however, need to consider how to address cessation of the use of LIBOR for these documents in light of the considerations and recommendations noted above.

Loan Agreements with LMA pre-May 2018 Replacement of Screen Rate Clause

This (optional) version of the Replacement of Screen Rate Clause[1] provided that if a Screen Rate was not available for a relevant currency, then amendments relating to providing for a replacement benchmark rate could be made with Majority Lender consent. Again, this clause would only be triggered when the relevant Screen Rate ceases which will not occur until at least the end of 2021, depending on the currency concerned.

Loan Agreements with LMA post May 2018 Replacement of Screen Rate Clause (but prior to 2020 Supplements)

In May 2018, the LMA's (optional) "Replacement of Screen Rate" clause was revised and expanded to take account of the potential cessation of LIBOR (the "**Revised Replacement of Screen Rate Clause**"). Although inclusion in loan agreements remained optional and the clause was published as a stand-alone rider, uptake of its use increased and in 2020, the clause was added to the LMA's suite of recommended investment grade documentation[2]. Under this clause, amendments relating to the use of a replacement benchmark can be made with a lower consent threshold (often specified as Majority Lender) than may have otherwise been required. Optional wording allows for the operation of the clause to be contingent on the occurrence of a "Screen Rate Replacement Event". As any such event would be a trigger to an amendment process only – the parties will still need to decide whether and when to agree to make amendments to the transaction documentation. Unless specifically agreed, there would not be any notification requirements on any party to inform another that a Screen Rate Replacement Event had occurred.

Under this Revised Replacement of Screen Rate Clause, note that a Screen Rate Replacement Event which occurs in relation to one tenor of a Screen Rate will lead to the potential for an amendment process to facilitate replacement of the Screen Rate for that tenor only and not to the potential replacement of that Screen Rate for all tenors.

In relation to the cessation of certain LIBOR tenors, paragraph (b)(iii) of the definition of "Screen Rate Replacement Event" provides that such an event may occur where "*the supervisor of the administrator of that Screen Rate*

[1] This optional provision was included in the LMA's documentation from November 2014.
[2] For example, Clause 35.4 (*Replacement of Screen Rate*) of the LMA's Multicurrency Term and Revolving Facilities Agreement.

publicly announces that such Screen Rate has been or will be permanently or indefinitely discontinued." Therefore, if a relevant tenor of a Screen Rate has been affected by the Announcement (i.e. all LIBOR settings other than the 1-month, 3-month and 6-month sterling and USD settings), a lower consent threshold will apply to amendments relating to the replacement of that tenor.

The clause did not contain drafting specifically providing for a pre-cessation trigger relating to an announcement of non-representativeness of a Screen Rate such as the Announcement. However, it is possible that other elements of the Screen Rate Replacement Event definition may be relevant. For example, paragraph (d) of the definition of Screen Rate Replacement Event, if included, allows the requisite majority of Lenders and the Obligors to agree that the relevant Screen Rate "*is otherwise no longer appropriate for the purposes of calculating interest under [the Agreement]*" thus allowing an amendment process under the Clause to commence.

Loan Agreements with LMA post-2018 Revised Replacement of Screen Rate Clause with 2020 Supplement(s)

In relation to the cessation of certain LIBOR tenors, the position detailed above in relation to the post May 2018 Replacement of Screen Rate Clause remains the same. However, in October 2020, the LMA published its suggested wording for a pre-cessation trigger[3] in its note "LMA Revised Replacement of Screen Rate Clause and pre-cessation trigger". If this wording has been included in any "*Replacement of Screen Rate*" clause[4] in any loan documentation, then, as this relates to an announcement that a Screen Rate is or, at a future date, will cease to be representative of the underlying market or economic reality that it is intended to measure and that such representativeness will not be restored, a Screen Rate Replacement Event (in relation to the relevant tenor of the Screen Rate) will have occurred as a result of the Announcement in relation to those LIBOR settings which may continue on a synthetic basis (i.e. certain sterling, USD and yen settings).

Questions therefore may arise for parties whose documentation contains a Revised Replacement of Screen Rate Clause with a pre-cessation trigger as to whether they would want to start an amendment process in the near future. This should also be considered in the context of the LMA's August 2020 supplement to the Revised Replacement of Screen Rate Clause which was published in line with the £RFR Working Group's recommendation that after the end of Q3 2020, documentation should contain contractual arrangements for "… an agreed process for renegotiation". If the wording from this supplement was included, it is likely that the parties will have specified a date by which they will commence the process of transitioning the documentation away from the use of LIBOR in any event.

Loan Agreements with Rate Switch Mechanics

In September 2020, the LMA launched its exposure draft Rate Switch Agreements which allowed parties to document transactions on the basis of forward-looking interbank term rates initially with a switch to backward-looking compounded risk-free references rates upon an agreed backstop date or an agreed trigger event ("**Rate Switch Mechanics**"). The LMA's exposure draft Multicurrency Compounded Rate/Term Rate Facilities Agreements published in January 2021 allow for the documentation of transactions based on backward-looking compounded risk-free reference rates at the outset but also contain similar Rate Switch Mechanics where forward-looking interbank term

[3] This is supplemental wording that may be added to any Replacement of Screen Rate Clause.
[4] For example, Clause 35.4 (*Replacement of Screen Rate*) of the LMA's Multicurrency Term and Revolving Facilities Agreement

rates are used. These documents contemplate "Rate Switch Trigger Events"[5], two of which are likely to be relevant for consideration.

As the supervisor of LIBOR has announced that it "*has been or will be permanently or indefinitely discontinued*" in relation to certain settings, then a "Rate Switch Trigger Event" will have occurred given the Announcement details the permanent cessation of certain LIBOR settings.

In addition, if a pre-cessation trigger is included as a Rate Switch Trigger Event, this would also be triggered by the Announcement as it relates to a public announcement that a rate "*is no longer, or as of a specified future date will no longer be, representative of the underlying market and the economic reality that it is intended to measure and that such representativeness will not be restored*".

In either case, the rate switch would then occur on the relevant Rate Switch Trigger Event Date which would be the date on which the relevant LIBOR ceases to be published or ceases to representative (as set out above).

However, note that the rate switch mechanics provide that, unless the parties agree otherwise, if a Rate Switch Trigger Event occurs for <u>one tenor only</u> of a relevant screen rate, this will trigger a switch to the use of compounded risk-free references rates for <u>all</u> tenors of that screen rate. Note that this position differs from that of the Revised Replacement of Screen Rate Clause described above (and which is also replicated in the Rate Switch Agreements and the Multicurrency Compounded Rate/Term Rate Facilities Agreements).

The Rate Switch Mechanics in the exposure draft Rate Switch Agreements and the Multicurrency Compounded Rate/Term Rate Facilities Agreements would require the Agent to notify the Borrower and the Lenders of the occurrence of a Rate Switch Trigger Event and of the consequent Rate Switch Trigger Event Date. They would also then need to notify the parties when the Rate Switch Date has occurred. However, as in this context the Rate Switch Trigger Event Date will not occur until immediately after 31 December 2021 at the earliest, it is likely that any backstop Rate Switch Date agreed between the parties (and therefore the rate switch) would occur prior to 31 December 2021 in any event.

Credit Adjustment Spread

In response to the FCA Announcement, ISDA has announced that *"Today's announcement constitutes an index cessation event under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings. As a result, the fallback spread adjustment published by Bloomberg is fixed as of the date of the announcement for all euro, sterling, Swiss franc, US dollar and yen LIBOR settings"*. The impact of this fallback spread adjustment fixing on loan documentation which references compounded risk-free reference rates will depend on the drafting included for any credit adjustment spread within the documentation. Given the commercial nature of this determination there is no particular drafting suggestion in the LMA's documentation but it is possible that drafting similar to that in ISDA documentation may have been included and thus a fixing has been triggered by the Announcement.

Under the Revised Replacement of Screen Rate Clause, if the amendment process facilitated by the clause has been triggered, parties may adjust pricing on a transaction to avoid transfer of economic value and if any adjustment has been nominated by a "Relevant Nominating Body" then the adjustment shall be determined on the basis of that designation. It is unlikely that the fixing of the spread adjustment for ISDA transactions as a result of the Announcement

[5] See Clause 9A.5 (*Definitions*) of the LMA's exposure draft Multicurrency Compounded Rate/Term Rate Facilities Agreement.

would constitute any such nomination by a Relevant Nominating Body as it is simply an announcement that a mechanic within the ISDA documentation has been triggered.

Transition away from use of LIBOR

The Announcement represents another step forward towards the cessation of LIBOR and a further catalyst towards transition away from its use. Parties to LIBOR referencing loan transactions must now, in light of the Announcement and the recommendations and priorities of the various currency and jurisdiction specific working groups, examine the terms of their documentation for existing transactions and consider the path to transition to the use of alternative rates.

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