The Working Group on
Sterling Risk-Free Reference Rates

Key messages and actions from webinar event:

Is your business prepared for LIBOR transition?

Broadcast on 18 September 2020, available to watch here

Please note that the views expressed by panellists in their presentations, which have been summarised in this document, are their own.

Panel session	Speakers	Title and firm
Introduction to LIBOR transition	Andrew Hauser	Executive Director of Markets at Bank of England
	Edwin Schooling Latter	Director Markets and Wholesale Policy at FCA
	Tushar Morzaria	Chair of Working Group Sterling Risk-Free Reference Rates (RFRWG) and Group Finance Director at Barclays
Transition developments in loan markets	Jamieson Thrower	Chair of RFRWG Loan Enablers Task Force and LIBOR Transition Business Lead at NatWest
	Frances Hinden	Vice Chair of Working Group and Vice President of Treasury Operations at Shell
	Chris Wilford	Head of Financial Services Policy at CBI
Active transition from existing LIBOR products	Katie Kelly	Senior Director at International Capital Market Association (ICMA)
	Shaun Kennedy	Group Treasurer at Associated British Ports
	Ian Fox	Group IBOR Transition Director at Lloyds Banking Group
International transition developments, and practical next steps for firms	Serge Gwynne	Partner at Oliver Wyman
	Chris Dickens	Chief Operating Officer EMEA at HSBC
	George Duncan	Head of Group Funding, Treasury at SSE
	James Winterton	Associate Director, Policy & Technical at Association of Corporate Treasurers (ACT)

Why does my firm need to transition away from LIBOR?

1. **The LIBOR benchmark is widely acknowledged not to be sufficiently robust or sustainable for such widespread use in global markets.** Due to structural changes in financial markets, the trading that used to underpin LIBOR – term unsecured lending between banks – has significantly reduced. As a result, LIBOR has become reliant on “expert judgement” and less so on underlying transactions.

2. **LIBOR cannot be guaranteed beyond 2021**, and its end will impact all types of businesses. As such, all firms exposed to LIBOR will need to be prepared to support alternative rates.

3. The behaviour of LIBOR rates during the height of the Covid-19 crisis (in March 2020) reinforced why transition away from LIBOR is important. The way LIBOR is constructed exposed borrowers to rising interest payments just as economic conditions worsened.

4. In sterling markets, the RFRWG identified SONIA as the preferred replacement rate. Unlike LIBOR, the rate is underpinned by deep and liquid markets.

5. Over the coming months, banks and lenders should increasingly offer SONIA products or begin discussions with their borrowers to address LIBOR exposures.

Checklist for firms to prepare for transition

- Firms need to begin engaging with transition efforts **now** to ensure they are ready for end-2021. You can use our linked resources – such as the factsheet and educational videos – to familiarise yourself with the key elements of transition.
- **From 1 October 2020**, all lenders should be ready to offer you products linked to SONIA or another non-LIBOR rate.
- If you do agree a new LIBOR loan in the **next 6 months**, your contract should include an arrangement to convert away from LIBOR ahead of end-2021.
- If you haven’t already, start to engage with your banks and counterparties about your options to end any existing reliance on LIBOR in your agreements.

What do I need to know about moving away from LIBOR in loan products?

1. LIBOR can be found in a range of contracts, including: loans; working capital adjustments; lease and rental contracts; and late payment fees.

2. From **1 October 2020**, your sterling lenders should offer you non-LIBOR alternatives for new loans. If you want a variable rate, this could be a product based on SONIA.

3. From **1 April 2021**, your sterling lender should not offer you new LIBOR loans.

4. SONIA, the RFRWG's preferred alternative benchmark in sterling markets, is not a like-for-like replacement of LIBOR. To use the new loan market standard of SONIA compounded in arrears, you will need to ensure your systems can work with the compounding calculation from that date. This includes your internal technology and Treasury Management Systems.

5. There are tools available (some of which are free) to facilitate your business in calculating interest payments linked to compounded SONIA. Be prepared to discuss the pros/cons of different approaches, including managing loans in a spreadsheet or relying on your bank to do calculations for you.

Checklist to prepare for lending linked to SONIA

- Identify your exposure to LIBOR. Check your contract terms for LIBOR, and the interest rate referenced in your facility letter or loan agreements.
  - If you do have exposure to LIBOR, are you able to refinance with an alternative rate? Can you introduce a “conversion mechanism” that would see you move to an alternative rate before end-2021?
- If you need a new sterling loan agreement, ask about SONIA or other non-LIBOR rates.
- Check whether your IT and treasury management can support SONIA compounded in arrears (or your chosen rate).
- Banks and lenders should be reaching out to you imminently if your borrowing is linked to GBP LIBOR. Be prepared for these discussions and your business requirements – e.g. if you need advance certainty of your interest payments, what are your options?

What do I need to know about actively transitioning legacy bond contracts referencing LIBOR?

1. **The terms in GBP LIBOR-linked bonds issued prior to 2017 will likely not adequately consider a permanent end to LIBOR.** Without robust fallback terms considering the end of LIBOR, this could result in your bond fixing to the last LIBOR rate, becoming a fixed rate instrument.
2. GBP LIBOR-linked bonds issued between 2017-2019 likely consider the permanent end of LIBOR (and identify SONIA as the successor rate). **<u>But</u>** the terms likely do not consider the risks of LIBOR becoming unrepresentative or volatile in the event that panel banks begin to withdraw before LIBOR ends.
3. GBP LIBOR-linked bonds issued post 2019, are more likely to consider a successor rate for the permanent cessation of LIBOR, **<u>and</u>** if LIBOR becomes unrepresentative.
4. Through a process called consent solicitation, markets have seen holders vote to convert the floating rate in existing bonds and securitisations from LIBOR to SONIA. These examples have **“actively converted” away from LIBOR** before end-2021 to avoid the risks resulting from an abrupt end to LIBOR or the event that LIBOR becomes unrepresentative.

What do I need to know about actively transitioning legacy loan contracts referencing LIBOR?

1. It is important to consider active transition as this is the only way to have certainty about contractual continuity and control over the contractual terms in your loans when LIBOR ceases or is no longer representative.
2. The Working Group have recommended three major milestones for loans in the lead-up to end-2021:
    - **By end Q4 2020** – firms should identify viable contracts for conversion, and progress the active conversion of outstanding LIBOR loans to reduce the legacy volume
    - **By end Q1 2021** – firms should accelerate the active conversion of outstanding LIBOR loans
    - **By end Q2/Q3 2021** – firms should complete the active conversion of those viable loan contracts
3. The sterling market's preferred replacement rate for LIBOR is SONIA compounded in arrears. However other options are available depending on borrower needs – such as Bank Rate, fixed rates or (for a smaller portion of the market) a SONIA term rate.
4. One clear opportunity to move from LIBOR to SONIA is when refinancing, offering an immediate conversion. Other mechanisms to move from LIBOR could involve a "switch" mechanism introduced during refinancing, moving to SONIA at an agreed date.

Checklist to prepare for active conversion

- Familiarise yourself with the Working Group’s guidance on active transition.
- Identify and understand your exposure, for example: it’s type (floating rate note, bilateral or syndicated loan etc); the number of legacy LIBOR contracts held; the terms of any fallback provisions; and the implications of any currency and hedging arrangements.
- Identify your counterparties
- Understand the benefits of moving away from LIBOR, including removing exposure to bank credit risk, and consider the suitability of active conversion across legacy products.
- Identify a replacement rate for LIBOR, i.e. SONIA, term SONIA, Bank Rate
- Familiarise yourself with calculating a fair pricing adjustment spread to account for economic differences between LIBOR and SONIA.

What do I need to know about transitioning away from LIBOR?

1. There is not a standard approach to transition loan products and as such firms may require bespoke arrangements, which may take time. Whilst your bank should be reaching out soon, it is **best for firms to engage early with transition** and arrange what is needed.
2. As part of reviewing your lending and commercial arrangements, it may be best to also consider transitioning away from LIBOR whilst amending these terms.
3. If SONIA is selected as the successor rate, you will need to understand how to use compounded in arrears SONIA in contracts. There are worked examples and calculators (some of which are free) to support calculating SONIA over the interest period before interest is due.
4. Different LIBOR currencies are working to different timelines. It will be important to keep informed of transition developments, for example via the Working Group’s monthly newsletter. To sign up to the newsletter, please email RFR.Secretariat@bankofengland.co.uk

Checklist for firms on preparing for transition

- **WHO:** Produce a communications plan and identify stakeholders. Internal – such as IT and treasury to support using SONIA (or other chosen rate). External – with banks and counterparties to update contractual arrangements and TMS providers to update systems to use SONIA (or other chosen rate).
- **WHICH:** There are different conventions to using SONIA, and other replacements available. Keep informed of transition developments through your bank and many other sources including the Working Group, authorities and trade associations such as CBI, ACT, UK Finance and LMA.
- **WHERE**: Where do your exposures sit? Not all exposure is obvious and you may need to conduct an internal audit to locate LIBOR. Examples may be found in intra-group loans, trade finance, late payment terms in invoices and defined benefit pension schemes.
- **WHAT**: Track down the individual contracts, discuss hedge accounting arrangements with your auditors, and check for pre-existing fallback clauses and whether these adequately consider LIBOR cessation and identify a replacement rate.
- **WHEN:** Agree how and when these LIBOR exposures will be treated, such as renegotiating, introducing a switch mechanism or active transition.

Where can I find out more about transition

- The full webinar event recording: https://www.youtube.com/watch?v=egJziWU8yAA
- Working Group website and LinkedIn page
- Association of Corporate Treasurers (ACT) LIBOR website
- Confederation of British Industry (CBI) website
- Working Group latest priorities and roadmap for 2020-21
- Working Group Factsheet "Calling time on LIBOR: Why you need to act now"
- Andrew Hauser speech "From LIBOR to SONIA: A bridge to the future"
- "Why do I need to transition away from LIBOR?" video and slides
- "Recommended next steps for transition" video and slides
- "What transition means for my lending agreements?" video and slides
- "Legal and documentation aspects of transition" video and slides
- CBI and UK Finance guide for business customers 'Discontinuation of LIBOR'
- Q&A on the changes targeted in the sterling loan market by end-September 2020, to reduce reliance on LIBOR ahead of end-2021
- Working Group recommendation on using compounded SONIA in arrears for sterling loans. Examples of SONIA-linked loans include National Express and Riverside Housing Facility.
- Working Group paper on practical next steps to actively transition existing loans referencing GBP LIBOR. Examples include South West Water and GlaxoSmithKline.
- Working Group paper on practical next steps to actively transition existing bonds referencing GBP LIBOR. Examples of converting bonds and securitisations include Associated British Ports and Lloyds.
- Working Group recommendations of the use case of non-LIBOR replacement rates across products
- Working Group statement on the use of SONIA Index in bond market conventions.
- Working Group paper on the identification of "tough legacy" contracts – those which do not have robust fallbacks and prove unable to be amended of LIBOR discontinuation.
- LMA exposure draft on using switch mechanisms in syndicated loan agreements (subscription required)