Active transition of legacy GBP LIBOR loan contracts – Timelines and considerations for borrowers

- **Borrowers should expect lenders to be engaging with them on the active transition of legacy GBP LIBOR contracts, aiming to complete this process by end-Q3 where possible.**
- **This reflects a milestone recommended by the Working Group on Sterling Risk-Free Reference Rates ("the Working Group")[1] intended to help to reduce resource constraints towards the end of 2021 and ensure preparedness for the cessation of GBP LIBOR at the end of 2021.**
- **Borrowers are encouraged to actively engage with their lenders and advisors to understand what this milestone means for them, how they can achieve it and how to ensure their readiness for LIBOR transition more broadly.**

Background

The industry-led transition away from LIBOR has been ongoing for many years. In March 2021, the FCA confirmed that all GBP LIBOR settings will either cease to be provided by any administrator or no longer be representative immediately after 31 December 2021.

The Working Group is an industry-led group supporting the transition from GBP LIBOR to SONIA in the sterling market. The overall objective of the Working Group is to catalyse a broad-based transition to SONIA, its preferred alternative to GBP LIBOR. In order to support a smooth transition from GBP LIBOR, it has published a transition roadmap that sets out key recommended milestones which all firms are encouraged to work towards.

What does the end-Q3 2021 milestone say?

The Working Group's roadmap sets an end-Q3 2021 recommended milestone to "complete active conversion of all legacy GBP LIBOR contracts expiring after end 2021 where viable and, if not viable, ensure robust fallbacks are adopted where possible." In March 2021, the PRA and FCA explicitly supported the Working Group milestones in a 'Dear CEO' letter which re-iterated supervisory expectations for regulated firms.

What does this mean for borrowers?

Lenders should be working with borrowers to agree active transition of lending agreements and other facilities wherever possible. The Working Group recommends this as the primary method to ensure contractual certainty and retain economic control.

Active transition is where LIBOR referencing contracts are amended to reference SONIA or another appropriate reference rate, either with immediate effect or through the inclusion of a contractual switch to such a rate at a specified date or event in the future (e.g. LIBOR being deemed to be no longer representative). This could include a contractual mechanism whereby the last interest fixing before end-2021 is based on LIBOR, before moving to an alternative rate for the first fixing date in 2022.

Why should I look to meet the end-Q3 milestone?

With all GBP LIBOR settings expected to either cease being provided or become permanently unrepresentative at the end of 2021, there are a number of potential benefits to actively transitioning LIBOR-linked contracts before this, and in line with the end-Q3 recommended milestone:

- **Resource constraints** – Borrowers will need to engage with their lender, as well as potentially seek legal, accounting or other external advice and update systems to accommodate alternative rates. Preparation for the amendment of contracts away from LIBOR may require borrowers to invest significant time and resources. Given the number of contracts to be transitioned across the market, there is a collective compression risk which may limit the availability or bandwidth of relevant professional services towards the end of the year. If left too close to the end of 2021, lenders may not be able to operationalise a high volume

[1] The Bank of England and the Financial Conduct Authority (the "FCA") are each ex-officio members of the Working Group. Market participants should note that the views and considerations set out in this document do not constitute guidance or legal advice from the Bank of England (including the Prudential Regulation Authority (the "PRA")) or the FCA and are not necessarily endorsed by the Bank of England (including the PRA) or the FCA. In addition, this document is not intended to impose any legal or regulatory obligations on market participants. This document has been prepared for the purpose of highlighting to market participants some of the potential considerations. It does not constitute a comprehensive outline of all relevant considerations. Market participants should seek their own advice in relation to their legal, regulatory, tax and other obligations and as to any other considerations or risks that may arise or be relevant.

of last-minute agreements to active transition. Acting promptly is more likely to ensure that borrowers can manage internal resources, access advisors (where appropriate) and that contracts can actively transition as intended.

- **Market liquidity –** As the end of the year approaches, liquidity in GBP LIBOR settings may decrease. Transitioning earlier may therefore allow borrowers to avoid any costs or difficulty associated with potentially lower liquidity. This is particularly relevant to those who intend to use market led strategies to transition their exposures.

- **Alternatives such as SONIA are robust and stable**, being rooted in active and liquid underlying markets. SONIA is now widely used across all core sterling markets, supporting a wide range of borrowers across different sectors.

- **Internal governance requirements** – Borrowers might need to factor these into transition plans. For instance, certain actions/approvals may need to be completed by relevant governing bodies, filing deadlines and other touchpoints with lenders and advisors. The end-Q3 recommended milestone is positioned to encourage all relevant parties to identify these relevant touchpoints and action their transition plans accordingly, well ahead of end-2021.

Do I need to take action if I have fallbacks in place?

Robust fallbacks can be an effective route to transition if they smoothly switch a contract to a new rate at a suitable point. However, in the Working Group's view, existing fallback provisions, unless they are contractually robust and specifically anticipate the envisaged end of GBP LIBOR, should not be relied upon as a primary method of transition.[2]

An April 2021 Working Group statement on active transition sets out some other further considerations to take into account when choosing whether to rely on fallbacks as the route to transition. This includes the level of operational risk of relying on fallbacks for a large volume of outstanding exposures which could arise after the year end.

Some borrowers may have heard that a 'synthetic' LIBOR rate may be available for 'tough legacy' contracts.

The FCA has proposed to use its new powers under the UK Benchmarks Regulation (BMR) to require a 'synthetic' LIBOR rate to be determined under a changed methodology, for more widely used 1-month, 3-month and 6-month GBP LIBOR settings (as well as three JPY LIBOR settings).

Where a 'synthetic' LIBOR rate is implemented, the FCA would also need to determine what use[3] would be permitted by UK supervised entities, and has sought market feedback on this[4]. The FCA has also been clear that any 'synthetic' LIBOR will be time limited and is intended as a safety-net only for contracts that cannot transition (i.e. 'tough legacy' contracts). The FCA has encouraged market participants to continue active transition away from LIBOR wherever practicable [and in line with relevant industry milestones], and not to delay their plans by waiting for a potential 'synthetic' solution.

What if I have multicurrency facilities?

Some borrowers may have multicurrency facilities, which may feature references to benchmarks other than GBP LIBOR (e.g. USD LIBOR and/or EURIBOR). Plans for transition of these facilities will need to take into account the circumstances of each benchmark involved, but where these facilities rely on GBP LIBOR (or other benchmarks due to cease or become unrepresentative at the end of 2021), the Working Group considers that action will nonetheless be needed on the timelines above. Engagement with lenders and advisors ahead of the end of Q3 should allow borrowers to develop clear plans and actions to ensure legacy contracts across all currencies are ready for LIBOR cessation.

Next Steps:

There are number of practical considerations for parties with GBP LIBOR contracts as we approach the end-Q3 milestone, which may take time to action or confirm. The Working Group encourages timely engagement with relevant parties and the preparations needed to ensure readiness for the recommended milestone on active transition. The

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[2] https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/active-transition-of-legacy-gbp-libor-contracts.pdf

[3] As defined under the UK Benchmarks Regulation

[4] https://www.fca.org.uk/news/press-releases/fca-consults-use-new-powers-support-orderly-wind-down-critical-benchmarks

Working Group has published documents aimed to support the active transition of legacy GBP LIBOR contracts, which can be found in the appendix.

Appendix – Working Group documents aimed to support the active transition of legacy GBP LIBOR contracts

Loans

- Active transition of legacy GBP LIBOR contracts
- Best Practice Guide for GBP Loans
- Credit adjustment spread methods for active transition of GBP LIBOR referencing loans
- Active transition of GBP LIBOR referencing loans
- New and legacy loan transactions referencing GBP LIBOR

Bonds

- Active transition of legacy GBP LIBOR contracts
- Active transition of GBP LIBOR referencing bonds
- Progress on the transition of LIBOR-referencing legacy bonds to SONIA by way of consent solicitation
- Transition from LIBOR in sterling structured products

Derivatives

- Active transition of legacy GBP LIBOR contracts
- Transition from LIBOR in sterling structured products