Progress on the Transition of LIBOR-Referencing Legacy Bonds to SONIA By Way Of Consent Solicitation

The Working Group on Sterling Risk-Free Reference Rates

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Statement on behalf of the Working Group on Sterling Risk-Free Reference Rates - Progress on the transition of LIBOR-referencing legacy bonds to SONIA by way of consent solicitation

The Sterling Risk-Free Rate Working Group (RFR WG) has welcomed the adoption of SONIA in new public issues of sterling floating rate notes, covered bonds and securitisations[1]. But the RFR WG recognises that there are certain outstanding bond contracts which reference sterling LIBOR and are due to mature beyond the end of 2021 – so called 'legacy bonds' – which need to be transitioned to a SONIA-based reference.

In the sterling bond market, many legacy bond contracts contain fallback provisions which may adversely impact the bond (for instance, by falling back to a fixed rate) or may otherwise result in contractual uncertainty, following the permanent discontinuation of LIBOR, or upon a declaration that LIBOR is no longer representative. The RFR WG considers that the most orderly transition from LIBOR to SONIA would be to replace or amend legacy bond contracts referencing LIBOR *before the fallback provisions are triggered*. In many cases, this can be achieved by way of consent solicitation: a market-based process generally set out in bond documentation which enables an issuer to amend bond conditions by way of bondholder consent.

To date, eight consent solicitations with a total nominal value of £4.2 billion have been announced publicly as successful in transitioning English law legacy bond contracts from LIBOR to SONIA.

The RFR WG welcomes the consent solicitations that have already taken place or are underway to transition legacy bond contracts from LIBOR to SONIA, and encourages all market participants to engage with the task of transitioning as many legacy bond contracts as possible (including by way of consent solicitation). Although consent solicitation may not be feasible or appropriate for *all* legacy bonds, undertaking consent solicitations will help to reduce market participants' exposure to LIBOR risks, and will reduce market disruption when LIBOR is permanently discontinued or is declared no longer representative.

Unless already provided for in the legacy bond contract, there are no mandatory terms of transition and parties may therefore agree on an appropriate arrangement. By way of illustration, in each of the consent solicitations which have already taken place: the interest rate provisions in the conditions of bonds have been amended so that, rather than referencing LIBOR going forward, they reference SONIA compounded daily in arrear over the relevant interest period, plus a fixed spread adjustment. The methodology for calculating the spread adjustment, which is used as a proxy to replicate the bank term credit risk premium and other influences on LIBOR, has been the linear interpolation for the relevant tenor of LIBOR vs SONIA basis swaps, which is then added to the original margin of the legacy bond.

The announcement of finalised arrangements for calculating a spread adjustment in contractual fallbacks in *derivatives* contracts[2], may further increase market participants' confidence in using market prices to price transitions to SONIA. Moreover, market participants may wish to consider whether current levels of liquidity in both the LIBOR and SONIA markets are conducive to completing transitions to SONIA in the months ahead based on this methodology.

To encourage and support market participants in transitioning more English law legacy bond contracts from LIBOR to SONIA by way of consent solicitation, the RFR WG is publishing with this statement considerations for the sterling bond market based on the experience of RFR WG members in undertaking consent solicitations so far. The considerations will be kept under review as the market gains more experience of consent solicitations for the transition from LIBOR to SONIA. They do not

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[1] SONIA-linked FRN issuance amounts to over £40 billion since June 2018, SONIA-linked securitisations distributed to investors amount to over £10 billion, and public issuance of LIBOR-linked sterling FRNs and securitisations with a maturity beyond the end of 2021 has all but ceased.

[2] https://www.isda.org/2019/11/15/isda-publishes-results-of-consultation-on-final-parameters-for-benchmark-fallback-adjustments/

impose legal or regulatory obligations on market participants, and are solely intended to facilitate the orderly transition of legacy transactions.

This statement is complementary to the forthcoming work of, and any publications by, the Cash Market Legacy Transition Task Force, that has been established by the RFRWG. That Task Force will be producing further material to assist market participants in transitioning legacy wholesale market bond and loan transactions to using the risk free rate benchmark.

Commenting on the success of the consent solicitations that have already taken place and on the release of the considerations, Tushar Morzaria, the Chair of the RFR WG, said: *"With the adoption of SONIA well underway, attention now must turn to the orderly transition of legacy transactions from LIBOR to SONIA. The success of the transitions already undertaken, together with the release of the considerations, indicate that the relevant tools are available, and it is now up to all market participants to use them".*

Edwin Schooling-Latter, Director of Markets and Wholesale Policy at the FCA, said: *"SONIA has now become the norm in new issuance of floating rate sterling bonds and securitisations, and it is encouraging to see the successful transition of LIBOR-referencing securities to SONIA. But there is still much more to do. We encourage market participants to build upon this momentum, and thank them for sharing these lessons learned from successful consent solicitations to date."*

Andrew Hauser, Executive Director Markets, Bank of England, said: *"I am very encouraged by today's publication, which demonstrates the constructive developments that have been made in legacy bond markets with regards to transition from LIBOR. This shows that transitioning existing bond contracts from LIBOR can be achieved in an orderly, effective manner – something which is crucial to ensuring a smooth transition. The Bank of England is supportive of this initiative and I urge all market participants, using the considerations set out in today's publication, to take steps that build on the substantial progress that has been made."*

Considerations for the conduct of consent solicitations to transition English law legacy bond contracts from LIBOR to SONIA

1. While market precedents are helpful in providing direction for the conduct and outcome of consent solicitations, each issuer and each bond is unique. Market participants should therefore carefully consider the suitability of consent solicitation as an appropriate course of action in respect of *each* relevant legacy bond, in all cases assessed on its own merits.

2. Given the interest of both issuers and investors in removing exposure to LIBOR risks, consent solicitations undertaken for this purpose have not typically involved the payment of consent fees (or any other incentives to vote on an extraordinary resolution to give effect to the proposed amendments to the conditions of the bond).

3. To facilitate open dialogue between an issuer and investors regarding the terms of the consent solicitation, the issuer may consider it appropriate to pre-announce a consent solicitation by way of an RNS announcement.

4. The principal aim of these consent solicitations is likely to be securing those amendments that are required for the transition of the relevant bonds to a replacement risk-free rate, and any necessary consequential amendments. Issuers and investors should together consider the necessity, as well as the consequences, of making any *additional* amendments to the conditions of the bonds.

5. Parties should consider the implications of any delay between the date on which the extraordinary resolution is passed and the pricing date for any adjustment spread relating to the replacement risk-free rate (the "Pricing Date") since market prices may move. This is also relevant to the timing between the Pricing Date and the date on which the amendment is deemed to be effective -in which case, a suitable adjustment mechanism may be necessary.

6. In order to ensure an efficient and methodical consent solicitation process, and to give investors sufficient time in which to analyse thoroughly the proposed amendments to the conditions of the bonds, all parties to the consent solicitation (including custodians, agents and trustees, if relevant) should have regard to the timing deadlines specified in the relevant bond documentation and ensure the timely sequencing of the steps required to give effect to the consent solicitation, including, but not limited to, delivery of notices and consent solicitation documentation to investors.