BULLETIN – 210118/54

ICMSA Bulletin – The discontinuation of LIBOR/IBORS – implications for English-law note trustees and agency roles – Update – Legacy Transactions

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The ICMSA has previously published bulletins on the implications for English-law agency and note trustee roles of the discontinuation of LIBOR and the transition to risk-free rates (see ICMSA Bulletin 181018/44 – *The discontinuation of LIBOR/IBORS – implications for English-law note trustees* (available here) and ICMSA Bulletin 190118/45 - *The discontinuation of LIBOR/IBORS – implications for English-law agency roles* (available here)). It remains the case that from the end of 2021, the UK Financial Conduct Authority (the FCA) will no longer require banks to participate in rate-setting number submissions for the London Interbank Offered Rate (LIBOR). With little more than 12 months until the likely cessation of LIBOR (or the ability to use any rate which continues to be published as "LIBOR" following the Financial Services Bill), this is an opportune time to assess how matters have progressed.

The legacy book

The apparent ease with which the market has been able to adapt to new interest rate methodologies on new transactions contrasts sharply with the growing concerns over the considerable number of existing transactions which reference LIBOR or one of the other inter-bank offered rates and which are due to mature after the end of 2021. As reported in ICMSA Bulletin 181018/44, fall-back language in legacy bonds was not drafted in contemplation of the permanent discontinuation of the relevant reference rate.

To date, the only effective way of providing for a permanent replacement of the interest-rate methodology on existing transactions has been for issuers to seek consent from their investors to the transition to a risk-free rate, and to include appropriate fall-back provisions to allow for the evolution of these provisions as the market settles upon a common approach. There are a growing number of consent solicitations launching each month, but the sheer number of affected transactions makes the challenge of completing this process for all affected transactions formidable.

No quick fix

The question continues to arise as to whether trustees under English law documents in particular are able to simplify the procedure for initiating the transition process. It is well known that trustees enjoy an array of discretionary powers and are empowered to agree changes to transactions documents without the consent of investors; agents generally have far less discretion.

This point was considered in ICMSA Bulletin 181018/44:

"*Note trustees will no doubt be supportive of efforts by issuers and noteholders to achieve this outcome on transactions. However, except in very rare cases (where transaction documents and terms and conditions explicitly allow), it will not be within the note trustee's power to exercise its discretion to* *amend the transactions documents to include the requisite language, meaning that noteholders' consent will be required.*"

A bond and the related transaction documentation can only be amended in accordance with the terms and conditions of the bond and the provisions of those transaction documents. Trustees and agents will therefore be constrained by the terms of the documents and will generally not be in a position to exercise discretion to remediate legacy transactions. Trustees and agents cannot be expected to act outside the powers bestowed on them by the documents where the terms and conditions of the bonds already provide mechanisms for amendments to be implemented by agreement between the issuer and holder(s) (and any impacted transaction parties) by way of consent solicitation or written resolution.

The transition of legacy LIBOR transactions is a process that will primarily need to be initiated and driven by issuers who, together with their advisers and sponsors, should be evaluating the options available to them for dealing with their LIBOR exposures. This process will require the active engagement and participation of a wide range of different parties and co-ordination between issuers, noteholders, transaction service providers and, in the vast majority of cases, the clearing systems. The use of consent solicitations to effect the relevant amendments is a viable and well-tested market based solution. However, as reported in ICMSA Bulletin 200610/50 - *The discontinuation of LIBOR/IBORS – timeline of a consent solicitation* (available here), consent solicitations involve legal, logistical and practical challenges and the market infrastructure may struggle to facilitate the mass transition of bonds if left to the final months of 2021. A follow up bulletin has now been published (here) and contains additional practical guidance and information for both issuers and investors in order to ensure that votes are submitted within required time frames. Trustees and agents may perhaps contact their own issuer clients to remind them about the impending cessation of LIBOR and the need to consider active transition and communication with their investors, messages which are consistent with the approach of the official sector and other industry bodies.

It is imperative that issuers, to the extent they have not done so already, review their back-book of outstanding securities referencing LIBOR and plan for active transition as soon as possible. Important points for issuers to consider will include identifying a "determination agent" for newer deals and confirming that agents will be able to calculate new rates using the desired methodology and timings. Issuers will also be cognisant of considering the effect of credit adjustment spreads on their investors.

The ICMSA's trustee and agency community notes recent proposals, in particular in the US, to provide a legislative solution to the problem of 'tough legacy'. Trustees and agents are supportive of an outcome which resolves the issue of the legacy book and provides a safe harbour for obligors and transaction service providers in moving transactions to risk-free rates. In the absence of such a solution beyond the US, trustees and agents expect to continue to engage with issuers, sponsors, swap counterparties, investors and other interested parties to address the issue on particular transactions on an *ad hoc* basis.

New transactions

The majority of new capital markets transactions issued in the last 18 months which reference a floating rate of interest have adopted alternatives to LIBOR as promulgated by monetary authorities for the major currencies in which debt is commonly issued or have provided for appropriate fall-backs in the event of LIBOR's discontinuance. By way of example, most sterling-denominated debt issuances now use Sterling Overnight Index Average (SONIA) as an alternative to LIBOR. Many new transactions which reference one of the new risk-free-rates have also adopted fall-back provisions in the event that those rates are discontinued or become unrepresentative at some time in the future. This development reflects the fact that the market is likely to continue to evolve following the cessation of LIBOR and other

IBORs, not least because the EU Benchmarks Regulation (EU 596/2014) requires an unrepresentative benchmark, whose representativeness cannot or will not be restored, to be discontinued within a reasonable period of time. Such fall-back provisions may allow a transaction to pivot to a different rate methodology in the event that the chosen methodology falls away or is no longer adopted by the market. For these reasons, it is not expected that the cessation of LIBOR will impact the market for new debt securities.

Conclusions

- Orderly transition of legacy notes from LIBOR to Risk Free Rates remains a challenge to the industry.
- Participants ought to work within their existing contractual arrangements to effect amendments and should not assume that their issuances will be able to, or should, rely on the so-called "synthetic LIBOR" following the Financial Services Bill or that trustees can exercise discretion in connection with transition.
- Investors may wish to make clear to issuers any desire to transition to a Risk Free Rate, and should ensure that they are ready to respond in timely manner to communications from issuers.
- Issuers in turn, whether corporates, financial institutions or SPVs, will need to ensure that they have reviewed their back-book of outstanding securities referencing LIBOR and made plans for active transition.
- All market participants will wish to avoid undue delay to transition resulting in an overload of amendment processes in late 2021 and practical difficulties in keeping to planned timelines.

Links to previous bulletins published by the ICMSA on the discontinuation of LIBOR/IBORs

- ICMSA Bulletin 181018/44 – *The discontinuation of LIBOR/IBORS – implications for English-law note trustees* – available here.
- ICMSA Bulletin 190118/45 - *The discontinuation of LIBOR/IBORS – implications for English-law agency roles* – available here.
- ICMSA Bulletin 200120/47 - *Benchmark replacement and fallback provisions - Key principles and guidelines for Agents and Trustees* – available here.
- ICMSA Bulletin 200305/49 - *The discontinuation of LIBOR/IBORS – different approaches for transition under English law trust deeds and New York law indentures* – available here.
- ICMSA Bulletin 200610/50 - *The discontinuation of LIBOR/IBORS – timeline of a consent solicitation* – available here.
- ICMSA Bulletin 210118/55 - *The discontinuation of LIBOR/IBORS – operational and procedural considerations for Consent Solicitations and Written Resolutions* - available here.