Minutes of LIBOR Trade Association Working Party Meeting

held on 25 May 2021

Present:

ACT
GFMA
ICMA
ICMSA
ISDA
JSLA
LMA
LSTA
SIFMA
TACT
UK Finance

1. Introduction

The purpose of the meeting was for the trade associations to provide updates on any developments in respect of LIBOR transition since the last meeting.

2. ACT

The ACT noted that the milestone set by the Sterling Working Group on Risk-Free Reference Rates (**£RFRWG**) of end-Q1 for no new sterling LIBOR issuances had passed relatively smoothly. The focus at the ACT is now on active transition of legacy LIBOR contracts. The ACT highlighted that it hears from member feedback that parties are now starting to work through their legacy processes and parties are focusing on meeting end-Q3 deadlines. The ACT is also looking at US dollar market developments regarding term SOFR and its various alternatives.

The ACT noted that members are keen to understand the definition of tough legacy and the ACT is keeping a watching brief on legislative developments. The ACT is also looking at the UK Financial Conduct Authority's (**FCA**) consultation on its powers in respect of critical benchmarks. The ACT noted that it will circulate this to its members and will also look at responding.

Regarding education and outreach, the ACT continue to attend events, including international forums (such as in Africa). The ACT will hold its annual conference in mid-June which will include sessions on LIBOR. One of the sessions will include regulators from the US, UK and the eurozone and will focus on their views for the year ahead.

3. GFMA

GFMA will publish its next version of its monthly newsletter this week. These will continue to be regularly circulated and focus on regional and global updates to help its members keep abreast of the developments with respect to the transition.

4. ICMA update

ICMA noted that the £RFRWG published in May its recommendations on the successor rate for fallbacks in bond documentation referencing GBP LIBOR. This follows the summary of responses to the consultation which was published in March 2021. ICMA noted that the recommendations facilitate transition away from LIBOR for bonds that include so-called Type 2 and Type 3 fallbacks in bond documentation which are triggered on a pre-cessation or permanent cessation of LIBOR. ICMA highlighted that the fallbacks have not yet been triggered in the sterling market (with one being triggered in the US dollar market, that the ICMA knows of). This recommendation, along with the recommendation for a credit adjustment spread published in 2020 will make fallbacks easier to operate. ICMA highlighted that bonds which include Type 2 and Type 3 fallbacks are relatively few. ICMA is also looking at the FCA consultation on use of its powers in respect of critical benchmarks.

Regarding education and outreach, ICMA held an event on 25 May 2021 on LIBOR transition in APAC, co-hosted with Bloomberg. The event featured the launch of the report "ICMA-Bloomberg Guide to Tough Legacy Bonds in Asia Pacific" which included Bloomberg statistics. This is aimed at showing the tough legacy situation for LIBOR bonds in Asia Pacific. In particular, the report highlights consent solicitation processes and the situation for JPY LIBOR bonds. Following the FCA announcement on 5 March 2021, the FCA may consult on the publication of synthetic yen LIBOR for one additional year after end-2021 and a large back-book of tough legacy bonds (including those without fallbacks) exists which has been highlighted in the report.

ICMA is also recording its virtual AGM panel on 27 May which will include heads of various working groups (including for example, Edwin Schooling Latter of the FCA and £RFRWG). ICMA also continues to monitor consent solicitations in the market, which has picked up since last year although it is still not at the rate that was expected. ICMA noted that it hopes to get feedback during the upcoming Bond Market SubGroup meeting on what is still required to further encourage consent solicitations.

5. ICMSA update

ICMSA noted that it published on 10 May 2021 its bulletin on the role of calculation agents. ICMA highlighted that the same terminology has been used as that used in ISDA documentation, although with minor differences. ICMSA members have slightly different roles as calculation agents as these are often performed by different parties (such as third parties to a transaction, rather than lenders or borrowers to the transaction). Therefore member expectations vary slightly and the bulletin is targeted at this.

ICMSA is also looking at the FCA consultation on use of its powers in respect of critical benchmarks and is considering responding. ICMSA noted that members are seeing an increased interest from issuers on consent solicitations for legacy bonds and transitioning LIBOR-referencing bonds, which has now started to pick up, which is a warm welcome, albeit at a slower rate than expected.

6. ISDA update

ISDA noted that since the last call it has published supplements to the 2006 ISDA Definitions. This is aimed at facilitating the use of RFRs with conventions that may be similar to cash market conventions.

As a second-step, ISDA is working on developing FAQs and template confirmation language for various conventions. ISDA noted that there are a number of permutations and varieties of this (such as including different lookback periods). By developing confirmations, ISDA aims to demonstrate this optionality and show how the new provisions can be used to hedge RFRs. In addition, to help facilitate hedging, ISDA has also published along with the updated provisions, a Rate Option for the SONIA compounded index published by the Bank of England. ISDA is also working on rate options for SOFR, €STR and TONA indices as well as for SOFR, €STR and TONA averages. ISDA highlighted that the rate options will be drafted in a way where optionality is possible.

ISDA continues to work on facilitating hedging and has received many questions since publishing the supplements to the 2006 ISDA Definitions. ISDA highlighted that a majority of RFR-based swaps and other derivatives will use existing compounding conventions, existent in the OIS market and therefore the new ISDA conventions will only be necessary if parties want to include certain specific features such as lookbacks or shifts available in the cash market conventions.

ISDA also published a rate option supplement for USD BSBY as credit sensitive rates are starting to gain more demand, although this does not change anything in the ISDA fallback language.

7. JSLA update

JSLA noted that the Tokyo Term Risk-Free Rate (**TORF**) has been available since last month (April 2021). TORF and TONA are the main alternatives to JPY LIBOR, where TORF is fixed in advance whereas TONA is fixed in arrears.

JSLA noted that parties have started their preparations for including TORF and TONA in transactions, including from an administrative angle. The level of preparedness however largely varies between parties. Currently, JSLA has observed a few deals referencing TONA and TORF. JSLA noted that issuances of new LIBOR based transactions have to cease by end-June so transition will accelerate over the next few months. Similarly, the Cross Industry Committee on Japanese Yen Interest Rate Benchmarks published a roadmap on upcoming milestones for interest rate swaps. In particular, new yen interest rate swaps based on TONA instead of LIBOR should be adopted by no later than end-July. The initiation of new interest rate swaps referencing JPY LIBOR should cease by no later than end-September.

JSLA further noted that parties have just started to take action on transitioning to JPY LIBOR alternatives following the publication of TORF last month. JSLA will continue to support parties in their transition and help facilitate smooth transition.

8. LMA update

The LMA noted that it has been busy updating its existing suite of RFR documentation to cater for Brexit-related changes and the recent recommendations published on 11 May 2021 by the Euro Working Group on Risk-Free Rates (note: these documents were subsequently published on 28 May 2021). The LMA is also producing versions of its Investment Grade suite of documents based on RFRs and a version of one of its Developing Markets templates based on a compounding in arrear structure (note: these documents were subsequently published on 28 May 2021). The LMA noted that it hears from market participants in developing markets that a few parties have started to look at compounded in arrear structures with longer lookback periods (i.e. 10-20 day lookbacks) to provide more certainty of payment. The LMA noted that it is interesting that these are being looked at rather than compounded in advance structures. It will be interesting to see if this changes if term SOFR becomes available.

Regarding education, the LMA is preparing for its latest webinar which will be on 1 June 2021 and will include a live Q&A. (note: this was subsequently made available on demand).

The LMA is also looking at the FCA consultation on its use of powers in respect of critical benchmarks, and has encouraged its members to respond.

The LMA further noted that it continues to work on, and update, its list of RFR loans (note the most recent update was subsequently published on 27 May). In particular, the LMA noted that the market had seen the first leveraged loan referencing SONIA, which is a warm welcome for the leveraged loan market.

The LMA noted that overall the sterling market has fewer uncertainties now in comparison to in Q1, particularly following the end-Q1 milestones which were met on time. Currently, the focus is on transitioning legacy loans and prioritising the back-book stock given that the milestone for cessation of new LIBOR originations has now passed and there are already sufficient tools and conventions in the sterling market for new deals.

Regarding secondary loan trading documentation, the LMA noted that it is hoping to have a few remaining issues resolved (for example, around cost of carry conventions) over the next few weeks. The LMA highlighted that it will have more clarity on this in the next call.

9. LSTA update

The LSTA noted that following the US Alternative Reference Rates Committee (**ARRC**) announcement in March 2021 that the ARRC will not be in a position to recommend term SOFR by mid-2021, loan market participants searched for alternatives. This has contributed to the rise in popularity of credit sensitive rates. The LSTA noted the first syndicated loan referencing BSBY last week, which was co-arranged by Bank of America and Keybank, and a BSBY swap being done between Bank of America and JPMorgan. In addition, CME Group launched interest rate futures based on BSBY. The LSTA highlighted the increasing movement in the use of credit sensitive rates, in parallel to the ARRC announcement on 21 May 2021 that it has selected CME Group as the administrator for term SOFR. The LSTA noted that this places the market at a crossroads as two choices may now appear for forward-looking RFRs (term SOFR and credit sensitive rates). It is yet to be seen where the market will move towards, and the LSTA highlighted it is likely that we will see a mix. The LSTA is preparing for an environment which is likely to become more multi-rate than expected.

The LSTA noted that it is working closely with its business loans working group on conventions for compounded in advance methods. The LSTA also noted that it is seeing a new development arise with regard to fallback language. Where the ARRC hardwired language is used (which is seen in an estimated 60% of new loan originations in 2021) a new feature is being added where the borrower and the agent opt into a non-waterfall rate (for example, a credit sensitive rate) subject to a negative consent requirement for lenders, prior to LIBOR actually ceasing. The LSTA highlighted that this further indicates parties wanting to have the ability to adopt credit sensitive rates or similar forward-looking structures even before the ARRC recommends a term SOFR.

ICMA asked what the consensus around such credit sensitive rates are in the US dollar market and whether these are considered by the US dollar market as viable alternatives to SOFR. In particular, ICMA noted regulatory communications, in particular from UK regulators, which have cautioned against their use. The LSTA noted that credit sensitive rates are considered by some market participants to be viable alternatives in the US dollar market as it appears that they are easier for market participants to work with. The LSTA also highlighted that market participants have been frustrated by the delay for a recommendation on term SOFR. US regulators have not prohibited the use of credit sensitive rates and in many instances have mentioned that there may be several rates available for use in the US dollar market in place of USD LIBOR. In addition, market participants are aware that there is a risk that they may rely on rates that are built on a segment of the money market which may come under greater regulation in future. However, market participants may feel that they can address this risk through inclusion of robust fallback language.

The LMA noted that it might be interesting to see if developments change following a publication of term SOFR, particularly given that borrowers appeared to be critical of credit sensitive rates and in favour of term SOFR or SOFR in advance during the SOFR symposium. The LSTA agreed and highlighted that borrowers will ultimately decide the direction of the market. The LSTA highlighted that less sophisticated borrowers may decide on credit sensitive rates as they are easier to calculate and are more familiar, although more sophisticated borrowers may take a different approach. It is yet to be seen how this will develop. In addition, the LSTA highlighted that the licencing arrangement for CME Group (the ARRC's prospective recommended administrator for term SOFR) does not include derivatives before end-June 2023, so the LSTA is trying to work through this issue.

10. SIFMA update

SIFMA noted that since the previous call, there has been no further movements in regard to legislation. Following the legislative hearing in April, SIFMA, along with other trade associations, have been involved in advocacy for Federal legislation.

SIFMA highlighted that there has been a lot of activity recently from the ARRC around term rates. In particular, following the ARRC's recent update in May 2021, the likelihood for a recommended term SOFR rate has increased. This is also facilitated by the ARRC market indicators, published in May. In addition, in line with the ARRC's market indicator on changing the market convention for quoting USD derivatives contracts from LIBOR to SOFR, SIFMA noted that a working group of the Commodity Futures Trading Commission is working on looking at conventions.

The LMA noted that it may be too early to tell but queried if there is any indication of when the ARRC is able to recommend a term rate, particularly given that the ARRC has its derivatives market indicator as well as its indicator for visible growth in offerings of cash products linked to averages of SOFR, either in advance or in arrears. SIFMA noted that it is hard to predict, although the swap conventions are likely to change over the summer. SIFMA highlighted that the market may not be expected to meet each indicator in exact terms.

The LSTA agreed and added that the market indicators were intentionally drafted in a way to give confidence on creating a robust term rate, as well as in a way where the indicators can be met. It was further noted that there has been an appreciation by the ARRC for the need for a term rate for certain segments of cash products and it appears that a recommendation is likelier to happen now than it was earlier in March. The LSTA also highlighted that the indicator for visible growth in cash products linked to SOFR is specifically for an increase in offerings of cash products, rather than an increase in actual originations.

11. TACT update

TACT noted that it has seen that in many structured finance and securitised transactions, corporate trustees are being restricted during their restructurings, as a result of LIBOR transition. As a part of basic terms modifications, noteholders play a more active role, and trustees are less involved (unlike for example, in a consent solicitation).

12. UK Finance update

UK Finance continues to work on its outreach and communication programme. UK Finance further noted that it is presenting at an event for the ICAEW, along with the FCA, the Bank of England and Deloitte, on LIBOR transition. This will provide a high-level overview on LIBOR transition and is part of an ongoing project to educate market participants that are less involved in transition developments. UK Finance noted that this event will include accountancy-styled topics.

UK Finance highlighted that it will also respond to the FCA consultation on the use of its powers in respect of critical benchmarks.

13. AOB

The LMA thanked members of the Working Party for their updates. The date of the next meeting is to be set for June 2021 and minutes would be circulated.