LIBOR discontinuation and loans

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The UK market regulator has recently re-emphasised that LIBOR will not be sustainable beyond 2021, and that market participants need to have robust fallback arrangements in place. While good progress (led by the derivatives market) has been made on developing risk-free rates as the basis for alternatives, some of these rates have yet to be published, and the market is still some way from agreeing on the calculation of suitable credit spread adjustments. It is therefore not currently possible to provide for specific alternative rates in loan agreements. In light of this, there are a number of considerations to be aware of in respect of new and existing loan agreements which reference LIBOR and are due to mature after 2021.

Existing LMA fallback provisions

The recommended forms of syndicated loan agreement of the Loan Market Association (**LMA**) provide a waterfall of fallbacks in the event a reference rate ceases to be available. However, these are at best temporary measures, and are not suitable for replacing a discontinued rate in the longer term. Under the current provisions, if the fallbacks fail, the lenders (as a whole) and the borrower will need to negotiate and agree on an alternative rate.

Amendments to loan agreements

Under the LMA's standard amendments clause, amending a facility agreement to replace LIBOR with a risk-free rate would likely be an all lender decision, as this is likely to have the effect of reducing the interest payable on the loan. In addition, since 2014 the LMA has published an optional rider, allowing for replacement of one screen rate with another with Majority Lender consent only, and this is relatively frequently used in syndicated loan agreements.

However, this language was introduced in response to some of the challenges arising from the discontinuation of certain LIBOR currencies, and is not likely to be sufficient to cover a discontinuation of LIBOR generally.

As a result, in December 2018 the LMA published a revised form of replacement screen rate clause; if included in a loan agreement, this clause allows amendments relating to benchmark rates to be made with an even lower lender consent threshold, and for related adjustments (including to the Margin) to be made at the same time, giving greater flexibility for any necessary amendments.

Related hedging arrangements

Following the discontinuation of LIBOR, there could be a mismatch in payments under a loan agreement and any associated interest hedging, as the fallback rates for swaps and loans contemplated in the respective documentation may not operate in the same way or may be triggered at different points in time. For example, the International Swaps and Derivatives Association (**ISDA**) has published a Benchmarks Supplement which, if incorporated into a transaction, sets out a waterfall of fallbacks for the parties, which differs from that used in the LMA documentation. Obviously, any such mismatch could affect the borrower's funding arrangements. Similarly, lenders who have entered into swaps could face a similar mismatch, which could potentially impact their returns.

At the same time, ISDA is working to develop fallbacks for LIBOR (as well as other IBORS) which, once agreed on and introduced (by way of amendment to ISDA's Definitions Benchmarks Annex), will take precedence over the fallbacks under the Benchmarks Supplement. Given the effort being made by the loan market to follow the lead of the derivatives market, it can be hoped that the alternative rates agreed here will also be adopted by the loan market.

LIBOR in another form

It is also not beyond the realm of possibility that, notwithstanding the acceptance of an alternative benchmark rate in the market, some form of LIBOR would continue to be published, at least on a transitional basis, possibly based on submissions from fewer banks.

If a loan agreement does not include fallback provisions enabling a transition to an alternative rate, and the parties cannot agree otherwise, then this LIBOR in "another form" would likely continue to apply to the interest calculations (which might not be acceptable to the borrower and/or the lenders).

What can be done now?

- Be aware of which of your loan agreements (or associated hedging transactions) referencing LIBOR are due to mature after 2021
- Understand what fallbacks are contained in your loan agreements, and what are the relevant lender consent levels required in order to replace LIBOR with an alternative rate (and whether this extends to adjusting the Margin)
- Understand what fallbacks are contained in your hedging agreements, and whether these will automatically incorporate the amended ISDA Definitions Schedule
- Be prepared, together with your counterparties, to make any necessary amendments to your loan and hedging agreements once the alternative rates have been fully developed
- Consider including in your loan and hedging agreements provisions which may make it easier for any necessary amendments to be made in future (for example, including the revised Loan Market Association replacement screen rate clause), and consider who will bear the costs of any such amendments

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