Minutes of LIBOR Trade Association Working Party Meeting

held on 30 June 2021

via teleconference

Present:

AFB
AFME
ICMA
ICMSA
ISDA
JSLA
LMA
LSTA
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. AFB

AFB noted that the first quarter milestone set by the Sterling Working Group on Risk-Free Reference Rates (**£RFRWG**) for no new LIBOR-linked loan issuances seemed to pass relatively well from their members perspective.

3. AFME

AFME noted that there were no significant updates from AFME's side since the last meeting. AFME sent a response to the FCA consultation (**FCA CP 21/15**) on the use of critical benchmarks, supporting the ICMA response.

4. ICMA

ICMA highlighted that they have responded to the FCA CP 21/15 on the use of critical benchmarks. ICMA is now considering the latest FCA consultation (**FCA CP 21/19**), enabling the FCA to require IBA to change LIBOR methodology to a forward-looking term version of the relevant risk-free rate plus the fixed ISDA spread adjustment.

ICMA is also considering what other issues need to be addressed for the bond market as notified to them by the Bond Market Sub - Group (**BMSG**) members; this includes issues related to consent solicitations, the operation of fallbacks (as to which they are working with ICMSA and others on operational points) secondary market liquidity and other issues. These issues have been consolidated into a grid that will be presented at the next BMSG to see what - if anything - can be addressed.
ICMA is further considering whether as a result of the outcome of the ISDA consultation on ICE swap rates there needs to be a successor swap rate recommendation for reset bonds - which tend to be capital securities issued by financial institutions – and if so, whether that will require a full market consultation on what the successor swap rate recommendation should be, which is an outcome they would seek to avoid.

Elsewhere, ICMA is continuing to track consent solicitations undertaken; there have now been almost 70.

ICMA has also published its APAC report "ICMA-Bloomberg Guide to Tough Legacy Bonds in Asia Pacific" which shows the tough legacy situation for LIBOR bonds in Asia Pacific.

5. ICMSA

ICMSA's key priority since the last meeting was working on the FCA consultation CP 21/15 on the use of critical benchmarks CP 21/15, as to which they worked alongside ICMA and UK Finance.

ICMSA is currently working with ICMA and the BMSG on questions on how fallbacks work on transition. ICMSA members are seeing an uptake in the numbers of consent solicitations which are being considered, but have not necessarily launched. Anecdotally, there is more interest from a wider range of issuers in transitioning and seeking to be aware what will happen if no transition is undertaken.

ICMSA also noted the significant amount of yen transactions, both domestic and international, which have yet to be addressed and many of which have no fallbacks. Approximately 88% have no adequate fallbacks.

6. ISDA

ISDA responded to the FCA consultation CP 21/15 on the use of critical benchmarks and are looking at the consultation FCA CP 21/19 on synthetic LIBOR. From a derivatives perspective, they are emphasising the importance of allowing hedges to reference synthetic LIBOR, if the hedged instrument references it.

They are carrying out work on bespoke conventions for use of risk-free rates (RFRs). Their updated documents have been published, including a recent FAQ on the conventions. They will also publish templates that should be used to incorporate the new conventions that would hedge LMA and LSTA documentation.

They have also published the 2021 ISDA Interest Rate Derivatives Definitions on 14 June, which are an update to the 2006 Definitions (as amended by 70 supplements). These 2021 Definitions consolidate all the work ISDA has done, and is expected to be adopted by 4 October this year in the cleared and uncleared derivatives market. So derivatives may use the 2021 architecture and terminology rather than the 2006 ones. There is a 49 page document highlighting the differences between the 2006 and 2021 Definitions on the ISDA website, including a factsheet and a webinar in the planning.

The Consultation on ICE swap rates closes on 2 July and, pending the results, ISDA will be publishing documentation updates for implementing those swap rate fallbacks.

7. JSLA

JSLA noted that there are 3 milestones on JPY LIBOR transition:

- Issuance of new loans and bonds referencing LIBOR to cease by end of June 2021.
- Contracts for loans and bonds referencing LIBOR to be reduced substantially by the end of September 2021.
- New interest rate swaps for JPY LIBOR to be ceased by end of September 2021.

This is an ongoing process which will be further accelerated at the end of July. JSLA are supporting this transaction to complete the milestones by the end of September.

8. LMA

LMA noted that they have been working on a suite of RFR docs which were published at the end of May, comprising 11 investment grade facility agreements based on RFRs, and updated RFR documents in light of Euro Working Group recommendations. There is an end-Q3 deadline for reduction of LIBOR-linked loans. In June the LMA updated its existing Reference Rate Selection Agreement which supports amendment of legacy loan agreements. They are working with their LIBOR working party to see if there are other options available in terms of making amendments to loans – there is no one standard way of doing this, different parties are adopting different ways of amending their loans, so this is an exercise in identifying consistencies.

They further explained that trade confirmations for secondary markets are available and a user guide is being produced. A 'cost of carry' guidance has been produced, allowing secondary markets to continue functioning. The options suggested in the guidance are daily simple or use of the compounded index.

The LMA are also looking at their documents governed by EU laws – German, Spanish and French law documents – as they contain references to LIBOR..

The LMA continue to update their list of RFR loans, including for a compounded SOFR based loan in Russia. They responded to the FCA consultation CP 21/15 on the use of critical benchmarks and are looking at the new consultation FCA CP 21/19 on synthetic LIBOR. On education, they are doing interviews: most recently, with Lafarge Holcim on the Swiss market and multicurrency transactions, with an interview with three Export Credit Agencies to follow.

There has been discussion in the loan market around compounded indices and how they are used. It is largely agreed that the indices are good as a reconciliation tool, but otherwise are not suitable for use.

ICMA reported that in the FRN market, most FRNs use the long form formula over the index, and only a handful have used the index. Of over 200 FRNs (not including securitisations), almost all use the lag convention with 5 day lookback with maybe between 5 and 10 using index/shift.

9. LSTA

LSTA noted that in the US, when talking about replacement rates, they are more and more referring to anything other than SOFR compounded in arrears. There has been a lot of discussion on credit sensitive rates (CSR), term SOFR and daily simple SOFR. A few weeks ago, there were regulatory statements on CSR and BSBY at the Financial Stability Oversight Council's Principals meeting, which were largely focused on LIBOR transition. Banking regulators more or less endorsed term SOFR (on the basis that if there is no term SOFR, the market would use CSRs instead) for derivatives and cash market products, but acknowledged that other rates such as CSRs could be suitable for other products so long as people understood and had their eyes open to them. The SEC's Gary Gensler came out very strongly against CSRs.

The LSTA is working to accommodate all potential replacement rates, which would seem to be many. Institutional term loans will probably use term SOFR, but pure banking loans (untraded) will probably use CSRs. The ARRC is expected to make recommendations on term SOFR shortly.

Different rates could lead to fragmentation of liquidity. The true bank market which doesn't trade doesn't need liquidity, so if that went towards using CSR that would not lead to a liquidity fragmentation problem, although you need to ensure that systems can accommodate it. But for the institutional, traded loan market, fragmentation of rates could affect overall liquidity – and the market is starting to think about this. The market is also starting to understand the economic attraction of different rates, but not necessarily lobbying for one rate over another.

The LSTA are trying to explore the possibility in a single credit agreement of: (i) a CSR on bank tranches; and (ii) a SOFR rate on the institutional tranches.

Elsewhere, with their ARRC hat on, the LSTA had been working on conventions for daily simple and SOFR compounded in arrears, and are now working on compounded in advance and term conventions, and are considering how to facilitate the co-existence of all the rates.

From a transition perspective, there are to be no new LIBOR contracts after the end of 2021, but the question is what is a new LIBOR contract in the loan space. The LSTA are studying different scenarios, such as the position of existing RCFs which allow for LIBOR, or refinancing of an existing LIBOR loan (and whether those would be a new exposure).

10. UK Finance

UK Finance also responded to the FCA consultation 21/15 on tough legacy. Key themes included the importance of timely clarity from the official sector, questions around scope i.e. non-BMR contracts not technically impacted under the FS Act powers, and challenges in retail markets (particularly mortgages). UK Finance endorsed other responses including those of ICMA and ISDA.

UK Finance is now continuing to wait to see next steps on the HM Treasury safe harbour and public tabling of any legislation, and believe that additional steps to help protect from legal risk are important and are making these representations to HMT and the official sector.

In conjunction with the ACT, UK Finance is involved in currently ongoing work for a potential £RFRWG document aimed at corporates which explains the importance and role of the end-Q3 milestone, whilst also emphasising the benefits of early action. In particular, the avoidance of compression risk, the benefits of robust alternative rates, market liquidity considerations and interaction with internal governance requirements.

Members of the UK Finance export finance group gave a very positive reaction on clarity re USD term rate developments, as this is a key issue for this cohort.

11. AOB

LMA thanked members of the Working Party for their updates. Given the summer holidays the Working Party agreed that the next meeting is to be set for early September 2021 and minutes would be circulated.