Minutes of LIBOR Trade Association Working Party Meeting

held on 2 November 2021

via teleconference

Present:

ACT
ICMA
ICMSA
ISDA
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. LSTA update

The LSTA noted that it is beginning to see increased issuance of leveraged deals priced using SOFR, with 5 to 10 public deals emerging in October. There is also strong activity in the investment grade space, although these deals do not tend to be drawn whereas leveraged deals are drawn and traded. In the leveraged space, the LSTA has seen most loans adopt CME's forward-looking term SOFR. The deals have been issued with distinct credit adjustment spreads (**CAS**) that are generally based on tenor. For example, pricing of 10 basis points for a 1-month tenor, 15 basis points for a 3-month tenor and 25 basis points for a 6-month tenor have been seen.

These CAS figures are not close to the ARRC's spread adjustment for cash products, which is based on the ISDA five-year historic median approach. The ARRC's spread adjustment is currently much higher than spot and forward rates. The ARRC has made clear that its spread adjustment is for fallbacks only and not for new deals. As a result, parties are having discussions as to the CAS for new deals. The pricing of the CAS based on tenor represents a compromise between market participants on this issue.

The LSTA also noted that there was news of a CLO with a SOFR tranche priced on Thursday 28 October. Here, the CAS was embedded in the margin.

The LSTA is continuing to educate its members on the need, and application process, for CME term SOFR licences.

The LSTA noted that credit sensitive rates (**CSRs**) are still under discussion in the US market. There is regulatory pressure to ensure that CSRs are only used where necessary. Most recently, the OCC issued a statement echoing IOSCO's concerns over the use of CSRs, namely that they shared many of the negative characteristics of LIBOR. The OCC also laid out additional self-assessment requirements and the hurdles embedded in respect of questions surrounding CSRs.

The banks see the above as a tougher stance than that of the Federal Reserve, though market participants anticipate that CSRs will remain. With respect to the institutional loan market, the LSTA noted that there is little need or demand for CSRs and that SOFR is expected to be predominantly used in this space.

The LSTA also noted that there has been new guidance on what constitutes a 'new' USD LIBOR contract after year-end 2021. The guidance being given is that a 'new' contract would include an agreement that: (i) creates additional LIBOR exposure; or (ii) extends the term of an existing LIBOR contract. A draw on an existing revolving credit facility agreement would be permissible. However, for refinancings, extensions, and re-pricing, replacement rates should be used.

On the issue of uncommitted lines, the LSTA read the guidance as saying that banks will be unable to use USD LIBOR from 2022 onwards. This is despite previous optimism from banks that they were going to be able to use LIBOR for uncommitted lines after year-end.

On the legislative front, the LSTA noted that on 2 November there was a Senate hearing on tough legacy contracts. The ARRC, SIFMA and other trade groups have been trying to push through the proposed federal legislation so that there is a legislative solution for tough legacy contracts in the US.

The LMA asked whether any of the leveraged deals mentioned had closed. The LSTA responded that they had, but noted that it did not know if they had traded. It anticipated that there would be no problems in trading them since they were using forward-looking term SOFR.

3. ACT update

The ACT noted that, in the UK, it is receiving very few queries from corporates as they are busy working through the transition process and seem to understand what is required. However, there is some nervousness in the market regarding access to resources later in the year.

The ACT also noted the usefulness of the LSTA's USD and term SOFR updates as this is a topic that it is receiving queries on. Notably, questions are coming in regarding when market participants can use term SOFR and how they can avoid using CSRs. The ACT also noted that it is keen to see the various pieces of proposed legislation, both in the UK and the US, progressing through their respective legislative processes.

The ACT is not receiving many queries on tough legacy, though it anticipates that once focus shifts in early 2022, there will be many more questions on the subject.

The LMA asked whether the ACT was receiving any queries from borrowers on where they can find published compounded rates in a loans context. The ACT answered that it had not received any such questions recently, though noted that it expects that it may be asked this at some point in the future when parties are more embedded in alternative rates.

4. ICMA

ICMA noted that it is largely focusing on tough legacy and is following the progression of the Critical Benchmarks (References and Administrators' Liability) Bill (the **HMT Bill**) and its Explanatory Note through the UK's legislature.

Elsewhere, ICMA is thinking about any remaining implications and questions raised by the transition, for example where synthetic LIBOR will appear, and whether it will appear as a single number per number (i.e. rate plus CAS).

ICMA is also continuing to think about implications of the tough legacy solutions available for some types of fallbacks which will benefit from the availability of synthetic LIBOR.

ICMA is also working to identify any operational issues that market participants might face on the first day without LIBOR.

Elsewhere, ICMA noted that it is tracking the active transition of legacy bonds, which has been fairly positive but there is still more to do. ICMA noted that the FCA may not compel the publication of synthetic LIBOR for the full 10 years. So in summary, active transition remains important and focus has turned to how to continue with the messaging along these lines.

5. ICMSA update

ICMSA echoed a lot of the comments already made by ICMA. In particular, as far as the bond market is concerned, and especially for legacy transition, there is much work to be done.

ICMSA noted that it had responded to the latest FCA consultation. In its response, ICMSA expressed its agreement with the proposed policies and actions. ICMSA noted that there are some points to highlight. Notably, on the issue of contractual continuity, ICMSA considers it important that the figure for synthetic LIBOR should appear on the same screen, at the same time, and in the same manner as LIBOR so that calculation agents will be able to make seamless transition plans.

ICMSA also noted that it agrees with ICMA's points in relation to the issue of the FCA's annual review of its powers. ICMSA noted that the volume of sterling bond deals still to transition is significant, and some have maturities that extend far beyond the 10 year limit (with some being perpetual), so ICMSA is keen to see these issues addressed in due course.

ICMSA also noted that that it will be interesting to see whether there is an interest rate hike on 4 November from the Bank of England as this may also have some interesting repercussions in the market.

6. JSLA update

The JSLA was not able to attend the meeting, but had sent a summary update by email, which was read out:

Preparations for the cessation of the publication of Japanese yen LIBOR, which started in 2017, are now in their final stage.

The transition has been making progress in line with the Cross Industry Committee’s roadmap. Specifically, the issuance of new loans and bonds referencing Japanese yen LIBOR has already ceased and progress has been made with a smooth transition to TONA for overnight index swaps, from interest rate swaps referencing Japanese yen LIBOR.

With the end of the year approaching, the transition away from Japanese yen LIBOR has also been accelerating for legacy contracts.

According to three top banks, as for domestic syndicated loans, borrowers have already decided new benchmarks for almost all legacy contracts, and some voting and signing processes remain.

The LMA followed up with the JSLA as to what rates they were seeing being used in the loan market. The JSLA responded that where domestic syndicated yen legacy loans are being transitioned without related hedging, TORF was the most popular alternative rate. Where legacy loans are being transitioned with related hedging, TONA is generally more popular.

7. LMA update

The LMA noted that, on the day of the meeting, it had published Exposure Drafts of revised secondary documentation reflecting the use of RFRs.

The LMA had also launched a term SOFR exposure draft for use in developing markets jurisdictions, alongside a commentary. This is of course open to market participants, if they wish, to adapt the drafting for other types of transactions, including for corporate loans. However, the LMA was not planning to produce specific term SOFR wording for other sectors until market practice had developed.

The LMA noted that the Working Group on Euro RFRs **(€RFR WG)**, of which the LMA is a member, recently published minutes which included discussion on whether to request the European Commission to make a designation for a replacement rate in respect of sterling and yen LIBOR for EU law-governed contracts.

The LMA and the chairs of the €RFR WG have also been in discussions regarding the low uptake of the €RFR WG's recommendations on EURIBOR fallbacks, especially in the loan market. As part of the ongoing work of the €RFR WG there are expected to be discussions on methods to encourage adoption of the recommended fallbacks.

The LMA also noted that the £RFR Working Group published minutes of its September meeting, which includes statements from the FCA and the Bank of England on the use of term SOFR and how it relates to the use of multicurrency facilities. In the minutes, the FCA and Bank of England stress the importance of parties looking to the relevant currency guidelines. For sterling loans, they reiterated that compounded SONIA is the most appropriate rate, with term SONIA only being appropriate for very limited use cases. The LMA is publicising these minutes to its members, as it has received various queries on the FCA's views on term SOFR.

On the issue of tough legacy, the LMA has been reminding its members that the FCA's powers under the UK BMR to compel synthetic LIBOR are time limited and that the existence of synthetic LIBOR should not encourage market participants to stop actively transitioning their legacy book away from LIBOR.

The LMA endorsed the points that other members of the Working Party have raised in relation to communication regarding active transition. The LMA noted that it is now clear what market participants should do with new deals and with active transition, but the emphasis will need to change in 2022 identifying the pockets of tough legacy which emerge in the market and to focus on the operational logistics of dealing with them.

8. UK Finance update

UK Finance noted that, much like the other members of the Working Party, it is monitoring the progression of the HMT Bill through Parliament.

On the USD side, UK Finance noted that the LSTA's update was useful on discussions between supervisors and firms on what is permitted after year-end. From the UK perspective, there are some concerns given how inflexible the FCA's rules are with respect to exemptions to the new use prohibition. Some members have expressed concern that if the US provides more certainty or flexibility on some of the greyer areas, the UK's stance could move out of sync with the US.

UK Finance also responded to the recent FCA consultation. Amongst the key points raised in UK Finance's response was an encouragement to the FCA and HMT to finalise the rules promptly given overwhelming support for where the FCA has emerged in relation synthetic LIBOR permissions.

UK Finance also emphasised in its response the importance of not undermining firms who have already actively transitioned customers and to reduce the incentive for customers to challenge their transition on the basis that they should have been left to use synthetic LIBOR. UK Finance also noted that the FCA powers only relate to products within the scope of the UK BMR, although the FCA has been clear that it expects the markets generally to proceed with active transition. This could lead to some confusion over coverage.

UK Finance also included in its response a request for clarity on the annual review of powers of the FCA and how the review cycle will look like both from a timing and process point of view.

Otherwise, UK Finance has noted that the FCA announced that it will only publish synthetic LIBOR for yen settings for the duration of 2022 and not beyond. With an estimate of around 15,000 contracts using that synthetic yen LIBOR rate, UK Finance has noted that this merits detailed consideration as to whether this creates a risk of disruption both in the UK and internationally.

Finally, UK Finance noted that it is starting to field questions on the use of synthetic LIBOR outside of the UK. The broad assumption is that where there is no legislative solution or commentary in the relevant jurisdiction, synthetic LIBOR can be used in those contracts.

9. ISDA update

ISDA noted that it had also responded to the recent FCA consultation. Overall, ISDA strongly supports the position of the FCA in respect of synthetic LIBOR. ISDA's response raised issues similar to those already noted by the Working Party.

ISDA noted that it held a joint webinar with the LMA and LSTA on new ISDA confirmations and hedging of RFR-linked loans using the documentation of each of the trade associations. Over 400 people attended the webinar live, with 800 people registered and the webinar is now available on demand on ISDA's website.

ISDA will also be publishing fallbacks for USD LIBOR and Japanese yen LIBOR swap rates on 10 November. They will come out under both ISDA's 2006 and 2021 Definitions.

10. AOB

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