ICMA International Capital Market Association

Active transition of GBP LIBOR-referencing bonds

The Sterling Risk-Free Rate Working Group (£RFRWG) and the UK authorities are continuing to support a wide range of firms in preparing for the transition away from LIBOR before the end of 2021, when LIBOR is expected to cease. The authorities consider that the best and smoothest transition from LIBOR will be one in which contracts that reference LIBOR are replaced or amended before their relevant fallback provisions are triggered. In the UK Government's written statement in June[1], it said that "active transition of legacy contracts remains of key importance and provides the best route to certainty for parties to contracts referencing LIBOR. Parties who rely on regulatory action, enabled by the legislation the Government plans to bring forward, will not have control over the economic terms of that action. Moreover, regulatory action may not be able to address all issues or be practicable in all circumstances, for example where a methodology change is not feasible, or would not protect consumers or market integrity".

As part of this effort to encourage the active transition of legacy contracts, the £RFRWG recently released two publications setting out detailed information, practical steps and considerations relevant to the active transition of legacy cash products (including bonds, loans and securitisations): *Active Transition of GBP LIBOR-Referencing Loans*, and *Active Transition of GBP LIBOR-Referencing Bonds* (the "Bond Paper").

The Bond Paper focuses largely on floating rate notes (FRNs, which for these purposes includes FRNs issued pursuant to a securitisation) with fallbacks which would typically operate such that the FRN would fall back to a fixed rate on the permanent cessation of LIBOR[2], or with no fallbacks at all. It explains how active transition can be achieved by way of consent solicitation and draws upon recent examples of transitions which have already taken place using this mechanism.[3] It explains the need to transition to risk-free rates, and in particular, why it is important to transition before the fallbacks of the relevant FRNs are triggered.

Some of the practicalities relating to the consent solicitation mechanism are included in the Bond Paper, such as the quorum and voting thresholds that need to be achieved in order for an amendment to be successfully passed at a bondholder meeting. It explains how consent solicitation can be used to either amend the interest rate directly from LIBOR to SONIA, or to amend the fallbacks so that, on the occurrence of a specific event, the FRN will fall back to SONIA. In the consent solicitations that have been successfully undertaken so far, the former approach has been adopted. Some FRNs, particularly those issued as part of a securitisation structure, may involve more complexities, and there may be some regulatory and other issues arising with active transition, all of which is explored further in the paper.

The Bond Paper is primarily aimed at those who may be behind with their LIBOR transition planning. Its publication was accompanied by a webinar organised by the £RFRWG at which the authorities, corporates, banks, advisers and associations (including ICMA) involved in the transition away from LIBOR discussed active transition of cash products.

While market participants should carefully consider the suitability of consent solicitation as an appropriate course of action in respect of each relevant FRN, it is clear that the importance of active transition of affected FRNs is becoming increasingly apparent. As Edwin Schooling Latter, Director, Markets and Wholesale Policy at the FCA, said, "the only way for contractual counterparties to have certainty and control over the future of their obligations is to convert them by mutual agreement".[4]

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1. https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS307

2. See further "Fallbacks for LIBOR floating rate notes".

3. As at the date of this Quarterly Report, 21 consent solicitation transactions have been undertaken to amend LIBOR to SONIA.

4. https://www.fca.org.uk/news/speeches/libor-transition-critical-tasks-ahead-us-second-half-2020