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LIBOR – being discontinued by 2021?

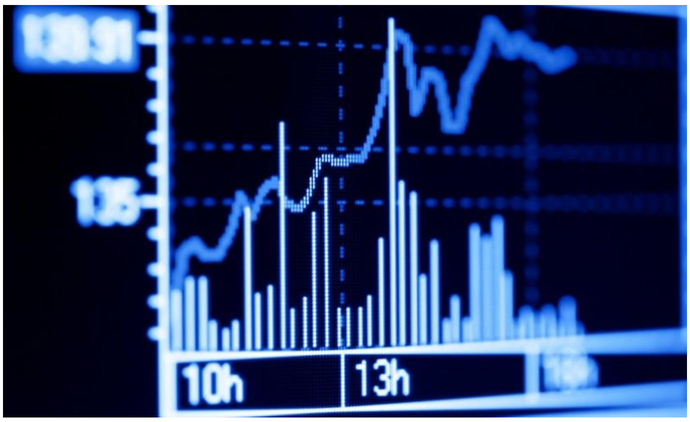
Key points:

- LIBOR will likely not be available after 2021.
- Existing documentation fall-back positions may not solve the resulting issues.
- With immediate effect, documentation being entered into (or amended) should contemplate what is to happen if LIBOR ceases to be available.

Background and summary

The Chief Executive of the UK's Financial Conduct Authority (the "**FCA**"), Andrew Bailey, delivered a speech on Thursday 27 July 2017, the implications of which include that LIBOR will likely cease to be available after the end of 2021. He also urged the sector to work in earnest on developing alternative reference rates based firmly on actual transactions.

LIBOR is currently administered by ICE Benchmark Administration ("**IBA**"), working with 20 panel banks submitting information from which the relevant rates are calculated. In his speech, Mr Bailey indicated the FCA wishes to achieve a position by the end of 2021 where transaction-based alternatives are available and "*it would no longer be necessary for the FCA to persuade, or compel, banks to submit to LIBOR*." The FCA is not abolishing LIBOR (and the IBA could theoretically continue to request information from the panel banks), but the practical consequence of the FCA no longer compelling banks to provide information is that LIBOR will most likely cease to be available.



What will replace LIBOR?

A replacement for LIBOR does not currently exist. The development of alternatives has been underway for some time, but they still require further refinement and market consideration before they can be used. These alternative benchmarks include:

- GBP: the possible use of SONIA, RONIA or ISDAFix; and
- USD: the possible use of the Overnight Bank Funding Rate or a rate based on overnight lending in the U.S. Treasury collateralised repurchase market.

There is now a far greater impetus on the market to develop and adopt alternative reference rates.

Implications for Existing Documentation

Existing forms of documentation cannot necessarily accommodate LIBOR entirely ceasing to be available. Although subject to negotiation, the Loan Market Association ("**LMA**") facility documentation contemplates that, in the absence of LIBOR, floating interest rates may be determined based on rates provided by a pre-agreed set of Reference Banks, failing which each lender may self-certify its cost of funds. These fall-back positions are intended to address short-term issues with the availability of LIBOR and not for long-term use.

The LMA facility documentation does include a mechanism for agreeing a substitute basis for determining rates of interest, but the provisions require the prior consent of all obligors and all lenders (and not just the Majority Lenders). Obtaining the agreement of all parties may not be straightforward.

Similar issues exist in other sectors such as derivatives contracts, bonds and other securities – any Reference Bank alternative is generally intended as a short-term solution and is not a practical long-term solution to LIBOR ceasing to be available after 2021.

Immediate Practical Implication

From a documentation perspective the key immediate point is that, with immediate effect, documentation currently being negotiated (or amended) and which is expected to remain in place after LIBOR ceases to exist needs to contemplate how the eventual (but currently unknown) replacement is going to be adopted, including lender consent / approval thresholds.

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