May 2020

THE IMPACT OF COVID-19 ON LIBOR TRANSITION PLANS

Introduction:

In 2017, the Financial Conduct Authority (**FCA**) announced its intention to stop compiling the interest rate benchmark LIBOR (London Interbank Offered Rate) by the end of 2021, because the FCA determined that the method by which LIBOR is calculated in practice no longer complies with internationally accepted principles for interest rate benchmarks. It is currently planned that LIBOR will transition to SONIA (Sterling Overnight Index Average), an alternative overnight risk-free rate for sterling transactions administered by the Bank of England, after the end of 2021. Other alternative overnight risk-free rates, such as SOFR (Secured Overnight Financing Rate) for USD transactions and €STR (Euro Short-Term Rate) for EUR transactions, will be transitioned by that date as well. Since LIBOR currently forms the basis of contracts affecting banks, asset managers, insurers and companies globally, a smooth transition is critical. In this article, we examine the impact of COVID-19 on firms' LIBOR transition plans over the coming months.

LIBOR Transition Plans:

In a joint statement made on 25th March, 2020 (available here), the FCA, the Bank of England and members of the Working Group on Sterling Risk-Free Reference Rates (the **Working Group**) confirmed that, despite the COVID-19 pandemic, firms cannot rely on LIBOR being published after the end of 2021 and that this should remain the target date for all firms to meet.

The FCA recognised that while many preparations in respect of the LIBOR transition would be able to continue as planned, certain aspects of transition programmes have been impacted by COVID-19. It was also noted that parts of the UK market (such as the loan

For further information on any of the issues discussed in this article please contact:

Conor Keaveny
Partner, Banking & Capital Markets
DD: + 353 (0)1 673 1722
conor.keaveny@dilloneustace.ie

Shona Hughes
Associate, Banking & Capital Markets
DD: + 353 (0)1 673 1712
shona.hughes@dilloneustace.ie

market) have made less progress on the transition and are still overly reliant on LIBOR, which would impact some of the interim transmission milestones.

In a further statement issued on 29th April, 2020 (available here) (the **Statement**), the Working Group recognised the challenges presented by COVID-19. However, the Working Group noted that there had been continued progress on the LIBOR transition (for example, they mentioned the first syndicated loan linked to SONIA and SOFR, the first bilateral loan referencing SONIA in the social housing sector and another successful consent solicitation to convert a legacy LIBOR referencing bond). It was also noted that the transition to SONIA in the bond market has largely been finalised. With regard to the loan market, the Statement noted that lenders will continue to endeavour to make SONIA-based products available before the end of Q3 2020 and that some borrowers will be prepared to avail of these alternative products before then.

However, the FCA, the Bank of England and the Working Group have acknowledged that it is not possible to complete the transition across all new sterling LIBOR linked loans prior to the original target date (Q3 2020). The Statement also acknowledged that there will likely be continued use of LIBOR-referencing loan products into Q4 2020, in particular to maintain the even flow of credit to the real economy.

In this regard, the Working Group has recommended the following measures:

- By the end of Q3 2020 lenders should be in a position to offer non-LIBOR linked products to their customers;
- After the end of Q3 2020, lenders, working with their borrowers, should include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion ahead of the end of 2021 through pre-agreed conversion terms or an agreed process for renegotiation, to SONIA or other alternatives; and
- The issuing of sterling LIBOR-referencing loan products that expire after the end of 2021 should cease by the end of Q1 2021.

The FCA, the Bank of England and the Working Group restated their commitment to continuing the momentum on the LIBOR transition, in spite of the economic uncertainty caused by COVID-19, and highlighted their focus on a number of key areas, including:

- Publishing the Working Group's analysis on, and considerations for, dealing with 'tough legacy' contracts;
- Building on the strong consensus on how to calculate a fair credit spread adjustment in legacy cash products to assist transition from LIBOR in cash markets; and
- When plans and working arrangements disrupted by COVID-19 begin to stabilise, the Working Group and its members will intensify communication with customers needing to move away from LIBOR as part of the transition.

Conclusion:

Considering the extent to which market participants currently rely on LIBOR, it is essential that a smooth transition is achieved. COVID-19 has clearly impacted firms' ability to prepare for the transition and has undoubtedly made an already complex task even more difficult. Alongside other international authorities, the FCA, the Bank of England and the Working Group will continue to monitor and assess the evolving impact of the pandemic on firms' LIBOR transition timelines and will update the market as soon as possible. The FCA have stated that this transition remains an essential task which will strengthen the global financial system.

DILLON EUSTACE

Dublin
33 Sir John Rogerson's Quay, Dublin 2, Ireland. Tel: +353 1 667 0022 Fax: +353 1 667 0042.

Cayman Islands
Landmark Square, West Bay Road, PO Box 775, Grand Cayman KY1-9006, Cayman Islands. Tel: +1 345 949 0022 Fax: +1 345 945 0042.

New York
245 Park Avenue, 39th Floor, New York, NY 10167, U.S.A. Tel: +1 212 792 4166 Fax: +1 212 792 4167.

Tokyo
12th Floor, Yurakucho Itocia Building, 2-7-1 Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan. Tel: +813 6860 4885 Fax: +813 6860 4501.