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LIBOR Transition: Start Planning!

The phasing out of LIBOR has undoubtedly created uncertainty for borrowers and lenders alike. This article provides a brief assessment of such uncertainty with the key takeaway for the c-suite being, *start planning*!

1. WHAT IS LIBOR?

The London Interbank Offered Rate (**LIBOR**) is a measure of the average rate at which banks are willing to borrow wholesale unsecured funds in the London market. It is administered by ICE Benchmark Administration. It is calculated based on submissions from selected panel banks and is currently produced in 7 tenors across 5 currencies.

On 27 July 2017, the Chief Executive Officer of the UK Financial Conduct Authority announced that market participants should not rely on LIBOR being available after 2021.

2. KEY RISKS TO BE AWARE OF

Central banks and market participants are working closely together to find an alternative to LIBOR, and progressing transition to new risk free rates (**RFRs**) such as SONIA . Whether or not an alternative will be identified on time and the effectiveness of such alternative is yet to be determined.

The fact however remains that LIBOR may become unavailable notwithstanding the fact that lending products and loan agreements referring to LIBOR remain in place. This will in turn mean that the parties will have to look into the contractual fall-back options currently present in their existing loan documentation.

Therefore, the key questions each corporate should ask itself include “what loan agreements within our portfolio refer to LIBOR”; “what are the contractual fall-back options under those loan agreements in the event that LIBOR ceases"; and "what are the potential operational, financial and legal implications for the company?”

The answers to the questions above depends on the specific drafting of each individual agreement, and there is no one size fits all approach that can be taken to a solution.

It is however certainly the case that legacy loan agreements which were entered into at a time when the unavailability of LIBOR was not contemplated do not expressly deal with the cessation of LIBOR. Under such legacy loan agreements, in the worst case scenario, a corporate under a loan agreement may end up having to rely on fall-back provisions drafted prior to the phasing out of LIBOR being contemplated which may result in the application of cost of funding (rather than LIBOR). In the current market climate, the former is a much higher rate than the latter potentially resulting in an increase in financing costs and therefore can be significantly detrimental to the corporate.

It is not inconceivable that the scenario above is likely to lead to litigation and questions arising in relation to the interpretation and enforceability of such fall-back provisions. Borrowers may argue that following cessation of LIBOR, the loan agreement is no longer possible to perform (the doctrine of frustration of purpose) and should therefore be terminated. Query if termination would be a viable option for a borrower which does not have an alternative financing arrangement in place, setting aside that there is no certainty that courts will uphold that a loan agreement is frustrated in such a scenario.

In the best case scenario where the fall-back provisions contemplate the phasing out of LIBOR, this is likely to be on the basis of an agreement by the parties to amend the terms of the relevant loan agreements (i.e. an agreement to agree) albeit with a lower lender consent level than would otherwise be required.

3. START PLANNING NOW

2020 is a critical year for the transition from LIBOR.

At King & Spalding, our lawyers consistently advise our corporate clients to be proactive.

The key initial step is to ascertain and fully understand the level of risk and exposure to LIBOR which your company is currently exposed to. As part of this step we recommend that you take stock of your existing financial instruments to identify the facilities which refer to LIBOR. This will in turn allow you to determine the fall-back option under each loan agreement in the event that LIBOR no longer exists.

Once there has been a full and thorough assessment of the level of legal, operational and commercial risk that the company is exposed to, it is time to start planning to be ahead of the curve.

This may entail the following actions:

- renegotiating the terms of the financing (if possible);
- making provisions for any adverse financial or operational implications;
- informing shareholders and investors alike of any impacted contracts (in particular any legacy contracts);
- being fully alert to the potential financial, operational and/or legal risks entailed and how such risks may be managed;
- actively monitoring progress in this area by tracking the latest developments; and
- implanting operational readiness for understanding, and managing RFR facilities within your companies.

One year away from the potential phasing out of LIBOR, the wait-and see-approach will no longer work!

If you require any assistance with understanding the issues or implementing the steps set out in this article, please do not hesitate to contact us.

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