LIBOR cessation: demystifying the switch to risk-free rates

This article was written by Dale Rayner and Jenny Zhao, with thanks to Alix Prentice, Richard Mazzochi, Jessie Chong and Helena Busljeta for their research and contributions

LIBOR cessation: demystifying the switch to risk-free rates

It's official. On 5 March 2021 the UK Financial Conduct Authority (FCA) announced[1] that all LIBOR settings will either cease to be published by any administrator or will no longer be representative at specified future dates, with a clear message to market participants: "*act now and complete your transition by the end of 2021*." See our recommended "dates to diarise" below.

Market participants should consider whether FCA's latest announcement constitutes a pre-cessation or cessation trigger under their LIBOR-linked contracts. Where parties have incorporated Asia Pacific Loan Market Association (APLMA) or Loan Market Association (LMA) rate switch language in their contracts, the FCA announcement will likely (though not in all cases) constitute a "Rate Switch Trigger Event" for a rate switch currency. This means that the rate will switch to an RFR on the date on which the relevant LIBOR rate for the quoted tenor ceases to be published or otherwise becomes unavailable (or on any earlier date specified in the documents). Agents for syndicated lenders should be aware that certain notification obligations may have already been triggered under the contracts they manage.

The International Swaps & Derivatives Association (ISDA) has also confirmed[2] that the FCA announcement is an index cessation event under the LIBOR 2020 IBOR Fallbacks Protocol (the "Protocol"). As a result, the FCA announcement has locked in Bloomberg's fallback spread calculations for all Sterling, USD, Euro, Swiss Franc and JPY LIBOR settings. For clients who already adhere to the Protocol, their ISDA contracts will transition automatically to replacement rates when LIBOR ends.

With the clock now ticking louder towards the end of LIBOR, even the most reluctant observers are now aware that the question is no longer 'whether' or 'when', but 'how' to manage the transition.

In this digest, we provide an overview of what benchmark reform is, why this matters and what you should be doing to prepare your business.

Why is everyone talking about LIBOR?

The London Interbank Offered Rate (LIBOR) is a benchmark for short-term interest rates, currently administered by the Intercontinental Exchange (ICE). LIBOR is amongst the most widely used benchmark rate for calculating interest rates for derivatives, bonds and loans as well as a range of consumer lending products such as mortgages and student loans. It is also used as a gauge of market expectations regarding central bank interest rates, liquidity premiums in the money markets and an indicator of the health of the banking system. Other interbank rates are set for other currencies and jurisdictions, including EURIBOR, BBSW and HIBOR in financial centres such as Luxembourg, Sydney and Hongkong.

In setting the interbank rate, administrators rely on pricing submissions from a panel of international banks. Following the global financial crisis in 2007- 2008, there has been increased global scrutiny on the integrity of the benchmark rate setting process, and the LIBOR scandal in 2014 only served to

[1] https://www.fca.org.uk/news/press-releases/announcements-end-libor
[2] https://www.isda.org/2021/03/05/isda-statement-on-uk-fca-libor-announcement/

amplify calls for reform. In July 2014, the Financial Stability Board recommended a transition towards risk free rates (RFRs), ideally grounded in actual transactions and liquid markets rather than derived from a poll of selected banks. Andrew Bailey, the then-CEO of FCA set the gears in motion in July 2017, when he announced plans for the publication of LIBOR to cease after 2021.

Where are we now in relation to Sterling and USD LIBOR?

The global transition towards risk-free rates has slowly but surely gathered momentum, with industry and regulator discourse peaking in the past two years. Most market participants are now familiar with the notion that Sterling LIBOR and USD LIBOR will soon be replaced by the Sterling Overnight Index Average (SONIA) and Secured Overnight Financing Rate (SOFR), respectively.

We have set out below some key dates to diarise, including LIBOR cessation dates confirmed by the FCA on 5 March 2021. Existing LIBOR contracts which have not transitioned by the applicable cessation date may become subject to "tough legacy" proposals (see What are "tough legacy" proposals and will they apply to me?[3]).

Dates to diarise for Sterling LIBOR to SONIA transition

- After 31 March 2021:
  - No new Sterling LIBOR-linked loans, bonds, securitisations and linear derivatives (other than for risk management of existing positions) maturing after 2021.
  - All legacy Sterling LIBOR-linked contracts to be identified.
- After 30 September 2020: All legacy Sterling LIBOR-linked contracts to contain contractual arrangements to facilitate the switch to an RFR either through pre-agreed rate switch provisions or provisions setting out an agreed process for negotiation; and
- After 31 December 2021: Sterling LIBOR will cease to be published and all Sterling LIBOR-linked contracts must transition to replacement RFRs.*

** The FCA will consult on requiring the continued publication of 1, 3 and 6 month Sterling LIBOR settings on a non-representative, synthetic basis for a further period following cessation, pursuant to its "tough legacy" powers. See What are "tough legacy" proposals and will they apply to me?[4].*

Dates to diarise for USD LIBOR to SOFR transition

- After 30 June 2021: No new USD LIBOR-linked contracts.
- After 31 December 2021: 1 week, 2 month tenors for USD LIBOR will cease to be published and all USD LIBOR-linked contracts must transition to replacement RFRs.**
- After 30 June 2023: Remaining USD LIBOR tenors will cease to be published, and all remaining USD LIBOR-linked contracts must transition to replacement RFRs.***

***Whilst key USD LIBOR tenors (1, 3, 6 and 12 month settings) will continue to be published until June 2023, the NY Fed has warned that continued publication will be for the limited purpose of assisting with run-off of legacy contracts only. Lenders are expected take a proactive approach towards switching from USD LIBOR benchmark to SOFR (or other alternative RFRs) prior to June 2023. Reduced liquidity from increased movement away from LIBOR may also mean that the ICE rates will no longer reflect the underlying markets and rates.*

****The FCA will consider whether to require IBA to continue publishing of the 1-month, 3-month and 6-month US dollar LIBOR settings on a non-representative synthetic basis for a further period after the end of June 2023.*

[3] Insert hyperlink to relevant section of article

[4] Insert hyperlink to relevant section of article

RFRs across currencies and the world

RFRs are not the only alternative to LIBOR – for example RFRs may not be appropriate for small corporate loans, trade finance and Islamic finance. However, for the broader market, 5 key alternative RFRs have been designated to replace LIBOR for the 5 LIBOR currencies by national working groups ("National Working Groups") established in the LIBOR currency jurisdictions. They are summarised below.

Jurisdiction	Working Group	Legacy reference rate	Target RFR	Collateralisation	Administrator of RFR
UK	Working Group on Sterling Risk-Free Reference Rates (Sterling Working Group)	Sterling LIBOR	Sterling Overnight Index Average (SONIA)	Unsecured	Bank of England
US	Alternative Reference Rates Committee (ARRC)	USD LIBOR	Secured Overnight Financing Rate (SOFR)	Secured	Federal Reserve Bank of New York
EU	Working Group on Euro Risk-Free Rates (Euro Working Group)	EONIA	Euro Short Term Rate (ESTR)	Unsecured	European Central Bank
Switzerland	The National Working Group on Swiss Franc Reference Rates (Swiss Working Group)	CHF LIBOR	Swiss Average Rate Overnight (SARON)	Secured	SIX Swiss Exchange
Japan	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks (JPY Working Group)	JPY LIBOR	Tokyo Overnight Average Rate (TONA)	Unsecured	Bank of Japan

Some jurisdictions, including Australia, Canada, Japan and Hong Kong, have opted to retain and reform their own benchmark rates where reform was deemed possible (BBSW, CDOR, TIBOR and HIBOR). For example, BBSW in Australia is determined by reference to observable trading in bank bills and is therefore currently considered "robust". However if liquidity drops in those markets, the regulator retains the power to issue a non-representative statement which would also call for a transition to a RFR (in this case, the Australian Interbank Overnight Cash Rate (AONIA).

In Singapore, the Monetary Authority of Singapore has indicated that the Singapore Interbank Offered Rate (SIBOR) will be replaced by Singapore Overnight Rate Average (SORA) by end of 2024.

As at the date of this publication, the European Securities and Markets Authority (ESMA) has confirmed that EURIBOR will not be discontinued, although consultation efforts continue to be led by ESMA and the Euro Working Group in relation to recommended EURIBOR fallback trigger events to address the situation in which it would no longer be possible to continue applying EURIBOR and other conventions in relation to ESTR-.

Progress in the LIBOR space

Bonds and derivatives market

Following FCA's announcement in 2017, the bonds and derivatives markets have managed to move relatively quickly to alternative RFRs, led primarily by ISDA and the ARRC. The speed of the transition within the bonds and derivatives markets may be partly explained by existing regulatory and market pressure to reduce counterparty credit risk interbank exposures, which, as observed by the Bank of International Settlements in its March 2019 Quarterly Review, has caused banks to have "tilted their funding mix towards less risky sources of wholesale funding", for example towards repos, which are generally priced using overnight "near risk-free" rates. Risk-free rates have also increasingly been used in the derivatives market, with SONIA and SOFR linked contracts made available by major futures exchanges such as the Chicago Mercantile Exchange and the International Exchange since 2018. Additionally, the mandatory shift towards central clearing of standardised OTC derivatives have incentivised structural and technological developments in the derivatives market, further easing their transition to risk-free rates.

The latest culmination of this development was the ISDA IBOR Fallbacks Supplement and Protocol which came into effect on 25 January 2021 (see our previous insight[5] for more information). Many banks and counterparties have already adhered to the Protocol, enhancing certainty of replacement rates upon a fallback trigger event in the derivatives industry. Many regulators have issued statements "strongly encouraging" its adoption by banks and dealers in their jurisdictions. The Protocol covers OTC derivatives and does not cover loans and bonds.

Loans market

Most loan market participants have until recently chosen to take a "wait and see" approach (often for good reason in light of consumer conduct obligations questions and systems requirements). However, spearheaded by the Sterling Working Group (a group constituted by the Bank of England and other market participants) and the LMA, the loans market has seen increased engagement and dialogue with its participants in the past year, with significant strides towards market transition. LMA has been encouraging its members to voluntarily submit details of RFR-linked transactions for publication on its website. There is an increasing number of "trailblazer" facilities which have been trickling in since late 2020, including, for example, vaccine developer AstraZeneca's US$3.375 billion RFR-linked funding arrangement (which was structured across 9 bilateral arrangements and closed in December 2020).

With the disruption caused by the COVID-19 pandemic, it was widely speculated that the original 2021 cessation timeframe set by the FCA might be postponed. However, undeterred, the Sterling Working Group has recommended that all new issuance of sterling LIBOR referencing loans that expire after end of 2021 should cease by end of Q1 2021 and new USD LIBOR lending should cease by end of Q2 2021. It has also recommended that all legacy loan products must contain clear contractual arrangements to facilitate the switch to an RFR either through pre-agreed rate switch provisions or provisions setting out an agreed process for negotiation.

ARRC has recommended that all new USD LIBOR syndicated loans should include ARRC recommended (or substantially similar) hardwired fallback language and new USD LIBOR lending should cease by end of Q2 2021.

The Hong Kong Monetary Authority, banking regulator in Hong Kong, has also instructed banks to include adequate fallback provisions in all newly issued LIBOR-linked contracts maturing after 2021 by 1 January 2021, and to cease issuing new LIBOR-linked products maturing after 2021 by the end of Q2 2021.

In its November 2020 guidance (INFO 252[6]), the Australian Securities and Investment Commission (ASIC) joined the global chorus by recognising the rapidly approaching sunset dates and noting that Australian entities should consider the international milestone dates set by the Sterling Working Group and ARRC. ASIC has warned:

> "*entities have significant tasks ahead, especially regarding conduct risk, to ensure they are adequately prepared for LIBOR transition*"

The Australian regulator foreshadowed the potential for mismanaged transitions to have regulatory consequences including the risk of inappropriate, unethical or unlawful behaviour caused by an entity's practices, frameworks or education programs.

For those who had harboured any residual doubt that the publication of LIBOR settings will cease, the FCA through its announcement on 5 March 2021, has effectively removed any such doubt. From a

[5] https://www.kwm.com/en/au/knowledge/insights/replacing-ibors-in-derivatives-theres-a-protocol-for-that-20201022

[6] https://asic.gov.au/regulatory-resources/markets/financial-benchmarks/managing-conduct-risk-during-libor-transition/

practical perspective, subject to tough "legacy proposals", LIBOR will no longer be published by the abovementioned dates.

Can I simply rely on existing replacement of screen rate provisions in my loan?

Most floating rate loan agreements contain fallback provisions setting out what happens when the designated benchmark rate becomes replaced or otherwise becomes unavailable. These provisions are intended to act as a safety net but are not suitably used as a permanent fallback in the event of permanent cessation of the relevant rate. Before the Protocol, for derivatives, these fallbacks will usually be reference bank rates as determined by an agent. For loans, the ultimate fallback is often the lenders' cost of funds. For bond and note issuances, the parties often resort to using the last known historic rate as a fixed rate.

Obvious economic risks and hedging complications arise where a floating rate instrument suddenly becomes a fixed rate instrument. Depending on the contractual provisions, parties can be left to negotiate alternative reference rates on an ad hoc basis, which creates uncertainty including with respect to the economic allocation of risk. This is particularly the case with syndicated loans, where provisions governing voting rights such as "yank the bank" or "snooze/lose" clauses can leave certain lenders disenfranchised.

What are "tough legacy" proposals and will they apply to me?

There has been some discussion around the introduction in various jurisdiction of "tough legacy" legislation. The term "tough legacy" has been coined to refer to financing arrangements which, for various reasons, are exceedingly complex or difficult to transition. These may include certain bonds or bilateral and syndicated loans with multiple stakeholders, where cost and resource availability pose particular challenges, and derivatives used to hedge such "tough legacy" contracts. In an effort to avoid a "cliff-edge" scenario within the market, regulators have been considering ways of alleviating the burden of transition for "tough legacy" contracts whilst mitigating litigation risk.

A recent example of a "tough legacy" measure is the UK Financial Services Bill (which has been passed by the House of Commons and is currently being scrutinised by the House of Lords). The law, when passed, will allow the FCA to officially declare a benchmark as being unrepresentative and prohibit its further use, whilst permitting certain categories of "tough legacy" contracts to be exempt from such prohibitions. Acting through the rate administrator, the FCA may preserve certain LIBOR currencies and tenors whilst directing changes to the calculation methods. The continued publication of LIBOR under this different methodology is referred to as the "synthetic LIBOR". While tempting, it is advisable to avoid relying on the continued ability to refer to synthetic LIBOR.

The FCA has indicated that the CHF and EUR LIBORs are unlikely to meet requirements under the new methodology, whilst synthetic Sterling LIBOR and JPY LIBOR are likely to be published for a specified period of time after cessation. The UK regulator is currently consulting on these proposals. In terms of how the synthetic rates will be calculated, the FCA has indicated that they envisage calculating Sterling synthetic LIBOR based on a forward-looking SONIA Term Rate plus a fixed adjustment spread under the ISDA methodology. However, it remains unclear precisely which contracts will be categorised by the regulator as "tough legacy".

From a contracting perspective, it is much more preferable to retain control over the economic effects of a rate switch, noting that a statutorily prescribed rate may not likely represent the bargain or timing that the parties would have struck had they chosen to amend their contracts.

Cross-border clients should also note the extra-territorial effect of many proposed tough legacy laws is uncertain, which can pose additional hurdles when attempting to scope and manage portfolios for eventual rate switch.

Key challenges – a breakdown

The discontinuation of LIBOR remains a huge challenge for most participants in the financial services market. Transition is a complex undertaking which might be simplified into two key mandates:

- future-proofing legacy contracts (by either converting the contract to an RFR linked contract or building in fallbacks which enable conversion upon the occurrence of specified triggers); and
- developing new RFR-linked products.

Having a plan and following through will be key to maintaining (or gaining) a competitive edge and allows greater control in times of uncertainty. Most legacy LIBOR loans require significant re-papering and lenders are keen to ensure they maintain a competitive edge when developing new RFR products.

Education	The first challenge for most market participants is often an educational one. There are a multitude of resources online, but the best way to gain an understanding tailored to your business is to reach out to your subject matter experts. Understanding the fundamentals of benchmark reform (including latest developments and timeframes) is crucial before tackling the next task of identifying where the key economic exposures are for the business and what to prioritise. The varying progress in LIBOR transition in different jurisdictions and the varying preferences in fallbacks for different financial products have made the education process a difficult one, particularly for market participants who have exposures in multiple currencies across different types of financial products.
Team/planning	The next challenge is to set up a core internal team to develop a phased action plan. This is where businesses can identify potential roadblocks and set up realistic targets and milestones. Whilst the focus may be to obtain the best possible economic result (in legacy cases this might be simply to ensure no losses), it is equally important to obtain trusted advice at this stage to ensure that seemingly "tangential" matters are adequately addressed, including documentary, regulatory, accounting, tax and potential litigation risk. Conduct risk is a key issue already flagged by regulators.
Roll-out/ engagement	During the roll-out phase, ensure the business has trained operations staff, experienced legal / financial advisers and effective relationship managers to drive the key transition action items. These can include initiating engagement with counterparties in relation to legacy contracts, surveying customer concerns and preferences, developing new RFR-linked products and re-documentation and precedent projects. In particular, agents for lenders in syndicated transactions should be prepared to manage counterparty discussions and ensure that their systems and operations are capable of accommodating a range of RFR options. Engagement between lenders in syndicates should also be sensitive to competition law concerns which have been raised in a number of markets.
Systems/tech	The final and arguably most pivotal challenge to overcome is technology and infrastructure. Even if counterparties have agreed a rate switch approach (whether or not already documented), they will each need to assess their actual operational capability to enter into and manage such an arrangement. Can the business's systems and processes accommodate the proposed changes? In this regard, the Sterling Working Group has acknowledged that finalisation of suitable software systems by loan systems providers and treasury management systems vendors is a crucial element in the adoption of risk-free rates and conventions, with a call to providers and vendors to ensure that such software becomes available by the end of March 2021.

Pricing and structuring challenges - avoiding economic mismatch

The table below summarises the key economic differences between legacy benchmark rates and RFRs. These differences will form the basis of detailed discussions between parties relating to structuring RFR products and pricing.

	Legacy benchmark	RFR	Developments
Methodology	Based on "waterfall" methodology which incorporates real transactions but also relies on expert judgment	Anchored in real transactions	Compounded risk-free rates are being published (for example the SONIA Compounded Index by the Bank of England[7]), however such indices are based on a prescribed methodology. It may not be appropriate to use these rates in all agreements (for example, if an agreement contemplates calculation of compounded interest without an observation shift). Generally, the calculation methodology used to compound risk-free rates should be drafted clearly in the relevant agreements, a notable change from the previous LIBOR format where agreements simply referred to a screen rate.
Term	Forward-looking rate, published for 7 different maturities ranging from overnight to 1 year	Backward looking rate, currently only available on an overnight basis	The Term SONIA Reference Rate (TSSR) is a forward looking risk-free reference rate published by IBA and Refinitiv Benchmark Services (UK) Limited (with 1, 3, 6, 12 month tenors denominated in sterling). Forwarding looking term RFRs are being developed for SOFR, TONA and ESTR. These rates may not be sufficiently robust at this stage to form the basis of a transition away from LIBOR, however they are being watched closely.
Credit Risk Adjustment	Includes risk adjustment to account for interbank credit spread and tenor	Minimal credit adjustment - RFRs are overnight rates and some RFRs are secured	ISDA recommendations have been published for derivatives and cash market recommendations have been published by the ARRC and Sterling Working Group in relation to how parties can determine the appropriate credit adjustment spread to address the economic difference between LIBOR and the relevant RFR. They recommend calculating the credit adjustment spread using the historic median between LIBOR and the relevant RFR over a 5 year lookback period.

Zooming in on: Backward looking rates

Participants should evaluate whether changes need to be made to their pricing, monitoring and risk management and reporting systems to ensure that they are able to trade, settle and manage backward

[7] https://www.bankofengland.co.uk/mfsd/iadb/NewIntermed.asp

looking rates as opposed to forwarding looking rates. For cross-currency swaps, this may be particularly challenging where there is a forward looking leg (for example, AUD in BBSW or HKD in HIBOR) and a backward looking second currency (Sterling in SONIA or USD in SOFR).

Zooming in on: Credit Adjustment Spread (CAS)

A key consideration for lenders when switching a product is how to maintain the status quo with respect to yields. One option is to increase the margin to ensure that the transition to an RFR is economically neutral. However in light of calls by regulators for fair treatment of customers in the context of LIBOR transition, lenders are increasingly pricing their products at the relevant RFR + CAS + margin. There are inherent challenges in calculating the CAS component, including the question of timing – should a CAS be fixed at the date of entering into a rate switch deal, or should a formula be embedded in the document to calculate the applicable adjustment as at the date of the switch? Could a formula then give rise to rate availability risks and the need for further fallbacks should the CAS component not be available?

ISDA has also published a statement noting that the FCA announcement on 5 March 2021 that LIBOR settings will either ceasing to be published constitutes an index cessation event under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings with the result that the fallback spread adjustment published by Bloomberg is fixed as of 5 March 202 for all euro, sterling, Swiss franc, US dollar and yen LIBOR settings.

Zooming in on: Zero floors

A consideration for all types of products is whether the applicable zero floor is to be applied to the sum of the RFR and the CAS, rather than solely the RFR. LMA flags this approach as most consistent with the approach previously adopted for LIBOR and it is also in line with the Sterling Working Group's recommendations.

Other issues which may arise include quantifying break costs, if any, in a post- LIBOR world. Given the arguments for charging break costs may not be as clear in RFR referencing loans, lenders may need to discuss charging an administrative fee or premium to accommodate mid-interest period payments.

Zooming in on: Interest rate calculation methodology and conventions for RFR loans

Arguably the most complex aspect of structuring a RFR-linked deal is the interest rate calculation methodology.

An RFR can only be calculated towards the end of an interest period so this means a borrower will not know what the interest will be until few days before the due date for payment (unlike a LIBOR loan where they would know this at the start of interest period). For an RFR to be suitable for loan, it is necessary to take the overnight RFR and convert into a rate that can be applied over a given term. Various calculation methodologies and conventions have been recommended by the National Working Groups for this process and they must be set out in the loan agreement.

In practice, there have been varying degrees of adherence to these conventions, reflecting the wide range of borrower and lender requirements in a range of asset classes. The different approaches have been the subject of keen scrutiny particularly for those tasked with setting organisation-wide precedents.

APLMA Rate Switch Agreement – a snapshot

For Australian clients wondering what the key discussion points will be when developing and negotiating a RFR-linked product, a useful tool is the *APLMA Exposure Draft Term and Multicurrency and Revolving Syndicated Facility Agreement incorporating Interest Rate Switch Provisions (Lookback without observation shift)* (APLMA Rate Switch Agreement), published on 15 January 2021 by APLMA (Australia branch).

The APLMA Rate Switch Agreement was drafted by King & Wood Mallesons for APLMA (Australia branch). It is based on the *LMA Exposure Draft Multicurrency Term and Revolving Facilities Agreement Incorporating Rate Switch Provisions (Lookback without Observation Shift)* published by LMA on 23 November 2020, with necessary changes to account for an AUD base currency and optional NZD and other currencies.

Alternatively, the APLMA Rate Switch Agreement may be used where an RFR for a particular currency is to apply from "day one" (ie the date of signing) with minor adjustments to the template.

The APLMA Rate Switch Agreement includes mechanisms for the conversion of the loan into a RFR-linked loan upon the occurrence of an Rate Switch Trigger Event Date or the Backstop Rate Switch Date (whichever is earlier).

The Rate Switch Trigger Event is defined to include various events including:

- cessation events: where an announcement is made that a screen rate has been, or will be, permanently or indefinitely discontinued or may no longer be used;
- pre-cessation events: where an announcement is made that a screen rate is no longer representative of the underlying market and the economic reality it is intended to measure; and
- early opt-in: the parties may include an early opt-in trigger if they want to transition at an earlier date (eg if they become operationally ready to do so).

The list of events or circumstances that trigger transition from LIBOR to RFRs should be examined closely to ensure compatibility across other fallback positions in related loans, bonds and derivatives prior to adoption. The FCA announcement on 5 March 2021 relation to certain LIBOR settings for Sterling and USD is an example of a "cessation event" and so is a Rate Switch Trigger Event.

The APLMA Rate Switch Agreement assumes that a CAS will be included, with no change to the applicable margin. The template is silent on whether the CAS will be a fixed percentage amount on "day one" or calculated on the rate switch date with reference to an agreed formula.

The APLMA Rate Switch Agreement has been prepared solely with the Sterling Working Group's recommendations on SONIA rate loans in mind. Accordingly, the document assumes the following Sterling LIBOR methodologies and applies them to all other currencies:

- uses compounding the rate in arrears;
- adopts a 5 business day lookback period with no observation shift (although recognising with observation shift as a viable alternative);
- applies of a zero floor to each daily interest rate prior to compounding; and
- assumes a daily non-cumulative compounding formula.

The APLMA Rate Switch Agreement is intended to serve as a reference point and leaves ample room for parties to negotiate bespoke terms. Parties are encouraged to carefully consider whether the mechanics proposed in the APLMA Rate Switch Agreement are suitable for their particular transaction.

APLMA has also developed a suite of English law governed discussion drafts of USD SOFR and rate switch facilities agreements for market participants in Asia-Pacific outside the Australian lending market. APLMA (Australia branch) will also soon release a "day one" RFR term and multicurrency syndicated facility agreement for use in the Australian market based on the LMA documents referred to below.

Recently published LMA documents

On 28 January 2021, LMA published two further exposures draft Multicurrency Compounded Rate / Term Rate Facilities Agreements (one incorporating lookback with observation shift and the other lookback without observation shift), together with a term sheet and commentary. LMA has further plans to release an exposure draft single SOFR facility agreement and single SONIA facility agreement to reflect published conventions.

Exposure drafts are designed to raise awareness of the continuing development of conventions and practices in the loans market and are not published as "recommended" forms of agreements to be taken "off the shelf" by market participants. Market practice is still in the early stages of development and participants will find that trends and precedents will continue to be honed as RFR linked transactions increase.

On 3 February 2021, LMA announced the further publication of a number of notes outlining high level LIBOR transition considerations for market participants outside the context of English law investment grade documentation.

Speak to us today

King & Wood Mallesons has been closely involved with industry consultations and have teamed up with financial advisers and technology platforms to find the best solutions for our clients. Reach out to us and find out how we can help your business today.