The Working Group on
Sterling Risk-Free Reference Rates

From LIBOR to SONIA and what you need to know:

What it means for your lending agreements

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Existing lending agreements

What to check for when looking at your existing contracts

1. Check which of your lending or other agreements have **LIBOR exposure**, which **currencies** these cover and when they will **mature**.

2. Look to see if these agreements already contain '**fallbacks**' setting out what will happen at the point LIBOR becomes unavailable.

If they DO contain 'fallbacks':

- These may not be adequate for a scenario in which LIBOR is *permanently* unavailable.
- Your lender is likely to still contact you to agree how to proactively amend your contract before LIBOR becomes unavailable.
- 'Fallbacks' in legacy contracts are useful but should not necessarily be relied upon as the primary route to transition.

If they DON'T contain 'fallbacks':

- Your lender will need to contact you to outline options and agree how your contract could be amended to transition to an alternative rate ahead of LIBOR becoming unavailable.

The RFR Working Group encourages the active transition of existing contracts where possible.

Existing lending agreements

The RFR Working Group's 5 key steps for the 'Active transition of Sterling LIBOR referencing loans'

Step 1. Review outstanding GBP LIBOR referencing loans (including multi-currency loans containing a GBP LIBOR option).

Step 2. Identify the alternative reference rate to be used for each loan (the industry working group have identified SONIA as the recommended replacement rate to Sterling Libor).

Step 3. Familiarise yourself with how the alternative reference rate will be calculated, and how to calculate any economic difference between GBP LIBOR and the selected alternative reference rate.

Step 4. Consider whether systems and operations are ready to accommodate alternative reference rates.

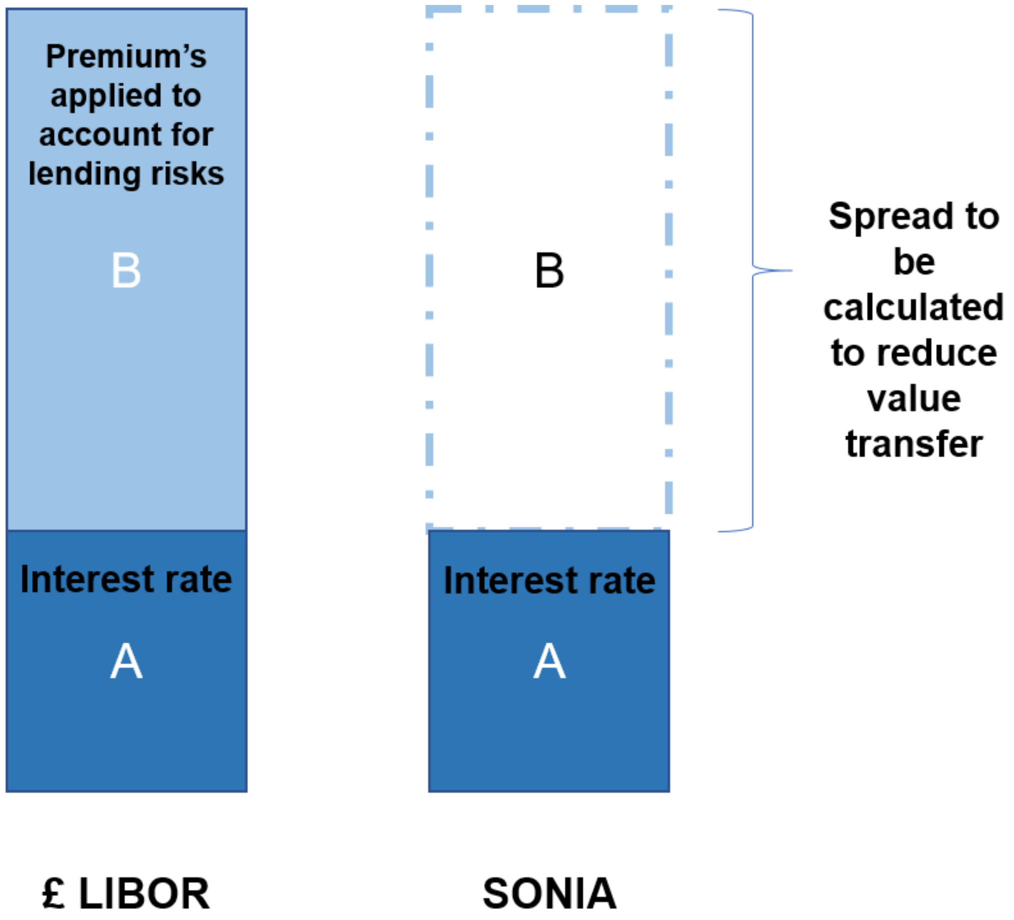
Step 5. Document the transition of the loans. All parties should also undertake appropriate due diligence on any changes that are proposed – ask your bank what preparations they are making and what that means for you/your business.

Credit Spread Adjustment

- Alternative rates, e.g. SONIA, and LIBOR are not economically equivalent as alternative rates do not include a credit component reflecting banks' lending costs.
- When transitioning a contract from LIBOR to an alternative rate, a credit spread is applied to account for this difference.
- It is designed to ensure a fair transition and prevent cost being transferred onto either party when the contract migrates to a new rate.

For more information watch the video on ***'What is a Credit Spread Adjustment?'***

Components of £ LIBOR and SONIA



New lending agreements

What to look for

You will increasingly be offered loans based on non-LIBOR rates, such as SONIA, from Q3 2020 onwards. The simplest way to not have to worry about new LIBOR-linked loans is to use alternative rates as they become available.

For those continuing to take out loans linked to LIBOR, from **Q3 this year**:

- Loans will contain legal language agreeing how the contract will convert <u>before</u> LIBOR becomes unavailable, ideally setting out the alternative rate and effective date for the change.
- If this is not possible upfront, you will still need to work with your lender to contractually agree a process to revisit the loan agreement before end-2021 to negotiate these terms.
- This language will be in addition to ‘fallback mechanisms’ - designed to convert the contract <u>at the point</u> of LIBOR cessation or when it is deemed no longer representative.

Key Conclusions

1. Now is the time to become familiar with what LIBOR Transition means for you and your lending agreements. Agreements which don’t foresee LIBOR ending are now a thing of the past and will need to be updated.

2. Lenders should offer lending agreements on non-LIBOR linked rates, such as SONIA, from Q3 2020 and cease LIBOR-linked lending from Q1 2021.

3. The more that is agreed up front in terms of setting out how this switch away from LIBOR will occur and to what rate, the less both lenders and borrowers will need to do in the crucial period at the end of 2021.

4. The credit spread adjustment is applied to achieve a fairer transition and avoid costs being transferred onto either party when a contract transitions away from LIBOR.

5. If in doubt, speaking with your lender is the simplest first step.

Key resources on LIBOR Transition

Prepare for conversations with your lender

Discontinuation of LIBOR: UK Finance Guide for Business Customers

'Calling time on LIBOR Why you need to act now' Factsheet

Transition from LIBOR – FCA webpage

Overnight Risk Free Rates: A User's Guide – Financial Stability Board

Educational videos - The Working Group on Sterling Risk-Free Reference Rates webpage