



Dorsey's Asia-Pacific Debt Capital Markets Practice

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Current Status of the Discontinuation of LIBOR

The London Interbank Overnight Rate ("LIBOR") is an interest rate calculation that is used globally for purposes of debt capital market transactions including bond issuances, loans and derivatives. In particular, LIBOR underpins many Floating Rate Notes ("FRNs"), which use the rate as a reference for purposes of calculating coupon. The intention is that LIBOR reflects the overall health of the financial system, which in turn is reflected in the coupon rate to be paid/received with regards to FRNs.

LIBOR is calculated by taking a cross-section of the average interest rate at which one bank can borrow from another bank. In the last several years however, LIBOR has been subject to a scandal of rigging, fraud and collusion amongst these banks. As a result, the UK Financial Conduct Authority ("FCA") has urged banks and institutions to move to other benchmarks by 2021, and will no longer require or encourage banks to publish these rates following 2021.

LIBOR underpins over \$300 trillion of global loans and this presents issues for all debt instruments that use LIBOR as a reference rate. Any issuers of FRNs or other debt instruments should be aware of this development and should take a closer look at their debt. Subsequent action may be required in light of the imminent discontinuation of LIBOR. Issuers thinking about issuing debt in the future should also be aware that the FCA has urged firms to start thinking about using alternative benchmarks and treat the LIBOR discontinuation event as something that will happen and for which they must be prepared.

The Issue

In July 2017, the FCA announced the discontinuation of LIBOR after it transpired that certain banks provided purported interest rate figures which did not truly reflect the rate at which they could borrow. This led to the distrust in LIBOR as an indicator for the real health of the global economy. The FCA announced that LIBOR will be discontinued in 2021 and different jurisdictions are currently considering alternatives to LIBOR. Possible alternatives include the Secured Overnight Financing Rate (SOFR) for the US, the Sterling Overnight Index Average (SONIA) for the UK, the Swiss Average Overnight Rate (SARON) for Switzerland and the Tokyo Overnight Average Rate (TONA) for Japan.

What this Means for Debt Capital Market Participants

Market participants are urged to review all their existing agreements that use LIBOR and do not mature by 2021 to determine whether these contracts have fallback clauses built-in for the situation where LIBOR ceases to permanently exist. If these contracts do not have adequate language that deal with this situation, market participants ought to amend these contracts to give effect for such a situation.

Most loans based on the standard Loan Market Association ("LMA") form contain a provision that covers the situation in which LIBOR temporarily ceases to be available. In such case, the lender's cost of funding or a stipulated Reference Bank Rate is used. However, as this fallback aims to provide temporary relief, rather than cover a situation in which LIBOR permanently ceases to be available, this can present further issues. After 2021, the FCA

will not require Reference Banks to continue publishing rates and in any case, administering this fallback will be costly in the long term.

Further, the LMA has been aiming to ease the transition of the discontinuation of LIBOR by publishing an optional 'Replacement of Screen Rate' clause, which was revised in mid 2018. This clause allows flexibility for the parties to choose a replacement benchmark following LIBOR with a majority-lender consent.

The Asia Pacific Loan Market Association ("APLMA") has followed suit and its agreements contain a modified version of the LMA's 'Replacement of Screen Rate' clause. APLMA's standard clause stipulates a majority-lender criteria for change of benchmark, but typically requires this to become an all-lender consent if the benchmark would result in a reduction in amount of interest payable.

Next steps

It is important for market participants to review existing LIBOR-linked debt that will not mature by 2021. The terms and intentions in which prior debt was transacted may not match the economic realities following the discontinuation of LIBOR in 2021. For example, FRNs that are linked to LIBOR may contain fallback language which stipulates that the latest available LIBOR should be used. This would effectively convert the floating rate loan into a fixed rate loan. Lenders and borrowers alike ought to be aware of this and start thinking about amending their debt agreements to give effect to the aims of the parties.

Further, issuers thinking about issuing future debt ought to take the above into consideration. Possibilities include linking debt to an alternative benchmark or engaging in conversation with counterparties to discuss implementing fallbacks in light of the above.

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