Insolvency & Bankruptcy

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For Private Circulation only | July 2020

CLIENT UPDATE: LIBOR TRANSITION

The London Interbank Offered Rate ("**LIBOR**") is a globally accepted benchmark interest rate, which represents the rate at which banks lend to one another in the international interbank market for short-term loans. It is likely that LIBOR will cease to be published after 2021, and will be replaced with an alternative "risk-free rate". While, new financing and finance documents will need to ensure new language and alternative rates, the change or transition of benchmark rates for existing transactions will raise certain issues and concerns; as these changes may necessitate negotiation and agreement between various parties. This will require market participants to review their financing arrangements to assess what steps they need to take to ensure a smooth transition to the replacement rates including the amendments required and negotiated between the parties to the financing documents.

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A. WHAT IS LIBOR?

LIBOR introduced in 1986, serves as a globally accepted key benchmark interest rate, which represents the rate at which banks lend to one another in the international interbank market for short-term loans. Intercontinental Exchange Benchmark Administration Limited ("**ICE**") administers LIBOR and publishes the interest rate on a daily basis.

B. WHY IS LIBOR BEING REPLACED?

In the last one decade, LIBOR has been undermined by twin scandals, as a result the effectiveness and reliability of LIBOR publications has come to question. The LIBOR submissions which were largely based on expert judgments rather than transactional data, led to concerns about LIBOR being unrepresentative and vulnerable to potential manipulation.

C. WHAT IS THE REPLACEMENT OF LIBOR?

- In July 2014, the Financial Stability Board comprised of regulators from G20 countries recommended in its report '*Reforming Major Interest Rate Benchmarks*' that financial institutions should transition away from LIBOR altogether to so called '*risk free rates*' ("**RFR**") which are benchmarks generally based on overnight deposit rates and are considered to be more robust.
- In July 2017, when the head of Britain's Financial Conduct Authority announced that LIBOR would be phased out and that banks would not be compelled to provide related details to ICE for LIBOR publications from end of 2021 ("**Phase-out Timeline**").

- A specific RFR is being identified for each currency for which LIBOR is currently published and the RFR will slowly replace LIBOR in the coming days.

D. STATUS OF LIBOR TRANSITION IN MAJOR ECONOMIES

The world has commenced taking progressive steps in implementing a currency specific RFRs. A brief update on the initiatives and steps taken in major financial economies are as follows:

- ***United States of America:*** USA has already initiated the process of LIBOR transition, with several USA based institutions issuing securities and writing contracts that has reference to the new RFR namely Secured Overnight Funding Rate ("**SOFR**").
- ***United Kingdom:*** In April 2017, the Sterling Working Group on RFR voted by more than two-thirds majority to approve Sterling Overnight Index Average ("**SONIA**"), as United Kingdom's preferred short-term interest rate benchmark. Thereafter, the Bank of England on April 23, 2018 took over administration of SONIA.
- ***Asian countries:*** Certain Asian jurisdictions such as Hong Kong, Japan and Australia have started engaging banks to start the transition from LIBOR, others including India are still at the nascent stages of the process.

E. LIBOR TRANSITION- INDIA

- India is lagging behind compared to some of the other countries in the LIBOR transition *inter alia* due to the underestimation of the impact of this transition from LIBOR. Although, many large banks in India have set up LIBOR transition committees to assess timelines for LIBOR transition.
- The Indian Banks Association ("**IBA**") has formed a working group, which is also involved in devising methodologies to negotiate LIBOR linked contracts.
- As per a study, the local banks and other market participants have majority exposure linked to US$ denominated LIBOR. Therefore, a general perception of replacing LIBOR with SOFR is prevalent. On a rough estimate, the IBA has ascertained that contracts estimated to be worth US$ 1 trillion may be renegotiated between Indian companies and the lenders.
- From an Indian legal standpoint, banks should gear up and start the process of identifying contracts and clauses to be re-negotiated, amended and drafted to ensure smooth and risk-free transition to an era post the Phase-out Timeline.
- Banks' reliance on '*fallback provisions*' which were provided in some of the existing contracts that appears to safeguard the interest of the banks post the Phase-out Timeline should be viewed with grim limelight. These provisions were incorporated to provide short-term respite, in an eventuality of LIBOR being unavailable for a short period of time as opposed to serve a long-term purpose.

F. CAVEATS AND RISKS

- ICE has also announced its intention to continue to work with panel banks to see if LIBOR could continue to be published post 2021 to support legacy transactions where it may be difficult to amend transaction documentation. However, ICE notes that banks should not rely on the continuation of LIBOR as an option as there is high probability that it would no longer pass regulatory tests of representativeness.
- Banks and other market participants with significant LIBOR positions who do not act quickly will increase both their risks and costs. Certain banks and other market participants may believe in '*stand aside and watch*' the steps and decisions taken by several foreign banks and international institutions. They will be ill-prepared to manage customers through the changes and to manage the associated implications.

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- If the banks do not act well in advance, this could lead to building up of exposures which reference LIBOR and thus, with the increased quantity of conversion work compressed into a tighter timeframe, exacerbating the disruption and attendant costs.
- If the LIBOR transition is not completed in time, the same might have adverse financial implication for the banks and even litigation in few cases.

- WAY FORWARD

  The transition process from an Indian legal standpoint is likely to encompass the following broad steps and timelines:

S. No.	LIBOR transition process	Description/ Steps	Timelines
1	Engagement of lawyers, scope of work and broad strategy.	The team / officers of the banks can start working with the lawyers to strategise and draw a roadmap of the LIBOR transition including identifying the legal issues involved, timelines of completing the transition in effective and efficient way and risks related to non-completion of transaction by the Phase-out Timeline.	September 2020
2	Due Diligence	Identification of the legal issues involved including the contracts, which would get affected by LIBOR transition. Identification of regulatory requirements, if any. Identification of the clauses of contracts that would require modification.	October 2020 – December 2020
3	Transaction-wise Strategies/ Steps	Formulation of the strategies/ steps to be taken in each account/ transaction identified as affected by LIBOR transition.	January 2021 – February 2021
4	Notification/ negotiations	Sending letters/ intimations/ notices to obligors or counter-parties for discussing, negotiating or taking next steps towards implementation of the LIBOR transition. Co-ordinating actions with other lenders in cases of consortium lending, considering provisions of the inter-creditor arrangements.	March 2021 – April 2021
5	Documentation	Finalisation of the language and modification of the identified clauses as required to suit the transition from LIBOR to preferred RFR. Finalisation/ standardisation of sample clauses for future contracts.	May 2021 – August 2021

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S. No.	LIBOR transition process	Description/ Steps	Timelines
6	Legal recourse	In case of failure of negotiation or in case of non-completion of any steps before the Phase-out Timeline, evaluation of options available for legal recourse against the obligors or counter-parties.	September 2021 onwards

The magnitude of the LIBOR transition and potential for financial / legal impact means that banks and financial institutions must start mobilising resources and take steps for the transition at the earliest.

G. SHARDUL AMARCHAND & CO. ("SAM & Co") SERVICES

SAM & Co can advise the banks pertaining to all the legal, regulatory and documentation issues from Indian law perspective. SAM & Co can collaborate with reputed foreign law firms having its personnel in various jurisdiction across the world, who can advise banks along with SAM & Co., in taking LIBOR transition steps, so that all the transition steps are taken effectively and in compliance with the legal and regulatory requirements from both Indian law and overseas law standpoint.

H. ABOUT SAM & CO.

SAM & Co., founded on a century of legal achievements, is one of India's leading full-service law firms. The Firm's mission is to enable business by providing solutions as trusted advisers through excellence, responsiveness, innovation and collaboration. SAM & Co is known globally for its exceptional practices in mergers & acquisitions, private equity, competition law, insolvency and bankruptcy, dispute resolution, capital markets, banking and finance and projects and infrastructure.

The Firm has a pan-India presence and has been at the helm of major headline transactions and litigations in all sectors, besides advising major multinational corporates on their entry into the Indian market and their business strategy. Currently, the Firm has over 600 lawyers including 115 Partners, offering legal services through its offices at New Delhi, Mumbai, Gurugram, Ahmedabad, Kolkata, Bengaluru and Chennai.

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