

Briefing Note: Managing the Transition from LIBOR to SONIA



CONTEXT

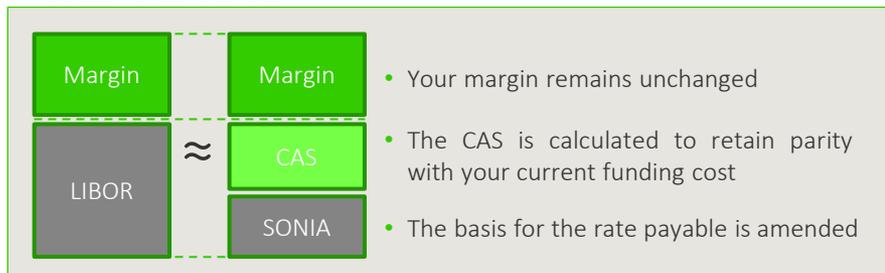
UK regulators have confirmed that the use of LIBOR will be phased out by the end of 2021 and replaced as a preferred reference interest rate by SONIA (Sterling Overnight Index Average). UK banks are now approaching borrowers to consider how and when to transition from LIBOR to SONIA. The change is significant and requires revision to existing financing documentation but doesn't need to be complex.

ABOUT SONIA

- Based on overnight interest rates in the wholesale markets.
- Reflects actual transactions and not reliant on reporting by banks.
- Uses compounded rates to produce a backward-looking term interest rate.
- Does not include either a term premium and interbank credit premium (unlike LIBOR, which is based on lending between banks for longer periods).
- Currently, SONIA can only be determined on a backward looking basis.

MOVING FROM LIBOR TO SONIA

- A market approach to achieving a 'no better, no worse' position for lenders and borrower has emerged on a consistent basis.
- Transition requires addition of a credit adjustment spread ("CAS") to SONIA reflecting the different risk premia used within the two rates (see below).
- The CAS is calculated based on the median difference between LIBOR and SONIA for the given tenor over the 5 year lookback period (now fixed as at 5 March 2021) or a forward adjustment using market implied rates.
- Banks may allow the Bank of England Base Rate as an alternative to SONIA in certain circumstances.



WHAT TO THINK ABOUT?

QMPF can support you in ensuring a smooth transition to SONIA and:

- Ensure you understand immediate and ongoing change to your financing.
- Consider the transition paths available: at cessation on 31 December 2021 or actively managed before then?
- Establish whether a BoE Base Rate alternative to SONIA is available to you?
- Understand hedging implications and benchmark revised swap rates for standalone or embedded fixed rates.
- Provide independent review of revised loan and hedging documentation.

PLEASE CONTACT US TO DISCUSS



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