A little bit of SONIA in my life…

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24/09/2021

As the market trembles its way into the final quarter of the year, minds turn sluggishly to the next big challenge facing lenders as the deadline looms for the demise of Libor and its similarly-named cousins across the globe.

Sources are divided on preparedness for the long-anticipated transition from established inter-bank lending rates that underpin many billions of dollars of loans across international infrastructure and energy sectors.

Every lender in the land should, of course, be turning now to that ominous-looking digital clock that has just switched from the soothing green setting to alarming red as the soft deadline set for the end of September lurks, ramping up to the hard one at the end of December.

Lenders that have not taken action in time for the end September deadline need to be ready in the coming 3 months to switch loans from established base rates to alternative reference rates (ARR) – AKA risk-free rates (RFR).

IJGlobal first wrote (biting knuckles) about the transition in early summer 2019 when the mood was as relaxed as a furloughed mechanic in the height of lockdown. It was revisited in the spring of 2020 when it was increasingly apparent that the lending community had taken an industrial-size chill pill.

Now, as we limp – weary and foot-sore – into Q4, to glimpse the 31 December finish line… you've got to ask yourself: "Should lenders not be looking an awful lot more nervous than they are?"

SONIA / SoFR – so what…?

In the UK, there are a handful of law firms doing the lion's share of the work on operational PFI / PPP projects – Ashurst, Pinsent Masons, Linklaters and CMS (if that's what they go by these days) – and they are run off their feet at a time when far more interesting things are on the table.

As one lawyer said: "Pretty much every deal I've ever done has come back to haunt me!"

So, while every banker complains about the money they're spending on legal fees – not their money, of course – the lawyers have the torpid task of revisiting every transaction they worked on to switch them over from Libor to SONIA.

Project finance transactions in the UK will not be done-and-dusted in time for next week's soft deadline, but the broadly-accepted view is that it will be pretty OK for the end of the year.

Given the complexity of PF deals, as structured finance deals involving swaps and loans, these are anything but vanilla transactions even if they were classed as "cookie cutter" at the time of financial close.

The stumbling block tends to be engaging with local authorities… which will come as no surprise to most folk.

The first challenge is to belay their suspicions that the private sector is trying to play them for fools (imagine), then explain it's not a refi, and then point them to a reputable source of information to explain what's happening in the finance community.

Once you've soothed the council rep's socialist angst and paranoia that The Man is not rinsing the local authority of every penny in its echoing coffers, and educated them on a point of finance… you then have to get them to pass this message on for approval at a higher level.

Anyone who has ever had any dealings with a local authority in the UK will instantly understand this is a full-time job for experienced project finance lawyers who could be far better deployed on more lucrative (not necessarily) work.

“Approaching people in local authorities to explain that they need to consent to this because their swap liability may – or may not – change if they terminate the contract in 5 years’ time… and they go: ‘Yoo wot?’” says one lawyer who bears the scars of many similar discussions.

“The local authority is the biggest issue and we are trying to get the IPA to issue some new guidance and they say they are having this signed off by ministers.”

Given the recent ministerial re-shuffle, that can only hindered things… but the IPA is fairly confident of having some guidance (that they will likely not read) to share with councils by the end of next week.

“Fundamentally, I think the majority of these deals could transition by the end of the year,” says a determined PFI lawyer. “But there is a huge volume issue and there just are not enough lawyers to do it.”

And the City says…

Talking to the lending community this week and they instantly bristle at the thought of lawyers making a living, being paid to do a job that most would not wish on their worst enemy.

But there is some positivity with one established banker saying: “Most lenders are ‘ready’… some more than others. But notwithstanding how lenders and borrowers are positioned to cope with the switch from Libor to RFR – like in so many cases – it all comes down to the money and how to split the costs amending transaction documentation. A feast for lawyers, a nightmare for everyone else.”

Another with a darker view of the world adds: “Borrowers with mixed lending groups have most difficulty, and depending on covenant test dates are potentially looking at significant break costs to fix issues.”

One lender with an international disposition says: “Some 12 months ago I would have said the industry was generally still in flux. Everyone looking at everyone else – especially from a middle- and back-office perspective. Our friends in the legal fraternity were in disarray as well as to the right language, etc.

“Roll forward to today and I’m very comfortable where we and most of all the major international banks stand. The most recent facilities incorporating new language for RFR, SoFR etc have all been pretty smooth.”

A banker with a confident air says: “Loan portfolio managers are having a bit of a hard time meeting the deadline due to process issues, but overall I don’t see the transition as having created any meaningful disruption, to be honest.”

And then there is the banker with a cautionary tale: “From what I understand, the issue with existing loans is that the borrowers are in denial! Agent banks are pushing them, but generally with little traction. I suspect it’s going to be on the radar of regulators very soon.”

Another adds: “New deals solution is clear and the market has already adjusted to the new world. Repapering of old deals is now moving ahead across our portfolio – momentum just gathered. Lenders are all now focused on this aspect and its importance… better late than never!

“The key commercial discussion topic is the adjustment spread between SONIA and Libor on swaps and loans. Frankly the rest is noise and lots of discussion for people who get paid by the hour! The thinking is now done and we are now moving into an industrialisation of this topic.”

And then there is the banker who was kind enough to score performance, rating his own institution at 8 out of 10:

- bank market – 7/10
- institutionals 4/10 – not helping borrowers meet deadlines
- borrowers 2-9/10

Finally the Friday afternoon banker who is also of a scoring frame of mind: “As I have just finished a 1 hour call on this very subject I’m still in pain! Most lenders are getting on with it, but there’s a tug of war as to who drives the bus – equity or debt! We’re about 7/8 on a 10 scale from what I know.”

