

# Fund Finance Friday



## Managing the Client Experience for Fund Sponsors Around LIBOR Succession Amendments

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Amending Fund Finance facilities to replace LIBOR as the primary benchmark interest rate has all the makings of a potential client experience disaster for your Fund sponsor clients. This is not just theoretical – we are starting to see real relationship strain develop in practice as a result of the amendment process. Below are our suggestions to best manage the client experience toward a favorable outcome for your Fund sponsors.

Communication. Nobody on the deal team is excited about amending documents to replace LIBOR. Banks feel (correctly) like they are bothering their Fund borrowers with this amendment burden. As a result, they may be looking to downplay it and are often communicating the need for the amendments through junior portfolio management personnel to junior Fund treasury personnel. This is a mistake. These amendments are major undertakings that could impact core economics of the transaction and should be communicated at the relationship level. Early communication on a game plan and process by a team that is knowledgeable about the process and complexities is important to set the stage for a successful transition.

Educate Yourself. Fund sponsor CFOs have the impression that these amendments are all straightforward, involving a single sentence that takes the term “LIBOR” and replaces it with “SOFR” throughout the Credit Agreement. But this is far from a “find and replace.” Many CFOs do not understand, nor can they be expected to understand, all of the various nuances (particularly in multi-currency facilities with syndication players) for making the required changes. There is no way a banker can adequately explain the scope and breadth of the required amendments for a particular deal effectively if he/she has not gotten fully fluent on what has to happen, why it is required and when it must be completed by. You should understand the differences in approach for the various currencies, between bilateral and syndicated loans, and between the U.S. and UK markets. SOFR comes in multiple primary varieties, with numerous other options (including to core economic concepts, such as application of a spread adjustment or a floor), that will need to be agreed upon. You cannot leave the details to the lawyers or to your juniors if you want to ensure your client is well-informed about the process.

Manage Expectations. At the outset, the senior deal banker should explain to the Fund CFO or other senior-level Fund contact:

- (i) This is difficult, none of us were asking for it, but it is required by worldwide regulators and we do not have a real choice.
- (ii) It is far more documentation-heavy than your expectations. The changes flow through the entirety of the Credit Agreement: the definitions, the borrowing request mechanics, the interest rate selections for each currency, the applicable margin calculations, the unavailability and illegality fallback sections, etc. The Credit Agreement will almost always need to be amended and restated – this is not a one-page amendment.
- (iii) The CFO himself or herself has to care and be engaged – the spreads are changing. The CFO has to understand and approve the new spread settings and their intersection with the new benchmarks, and this requires thorough, high-level attention.

(iv) There are massive variations in the scope of work required between different deals. A bilateral, U.S. dollar-only deal on a non-LSTA form credit agreement may amend somewhat simply, perhaps 10-15 pages of blacklining. But for a multicurrency deal, where each currency now has its own interest rate instead of LIBOR, together with its own definitions and mechanics, the amendment can compel 50-60 change pages of blacklining. For deals with lots of currencies, each one needs to be addressed individually. And syndicated deals are further complicated. Each bank may have different requirements around notice time periods for certain currencies, what rates are preferred and operationally supported (e.g., Term SOFR, compounded in arrears SOFR, daily simple SOFR), etc. Make sure your Fund contact understands that all deals will not amend similarly and has a good idea of the complexity of the amendment for a particular transaction.

(v) The time and expense are significant – we are seeing CFOs with expectations that the costs of these amendments will only be a few thousand dollars. The entire Credit Agreement needs to be re-read and amended and restated by senior lawyers – the expenses will be extensive from both bank and borrower law firms, and not getting out and messaging this upfront and honestly will not end well. This is not a situation where the CFO thinks the bills are coming in 10% higher than expectations; the bills on syndicated, multicurrency deals may come in 10 times their expectations if they are not properly guided.

Timing. Your Fund CFO and her treasury team, and their law firm, are busy making investments and fundraising (things they really care about). Because there is no cash funding involved here and no deadline around a LIBOR amendment in the Fund's view (there are, in fact, rapidly approaching deadlines for the banks), LIBOR amendments are naturally treated as a low priority and they drag. When comments come back four weeks later, the banker and senior lawyer naturally need to spend time refreshing, which drives up the costs. Encourage your Fund CFO to set and drive a timeline, communicate it to Fund counsel, and encourage everyone to stick with it. And get started! LIBOR is going away as of 12/31/21 for non-USD currencies, and these amendments are coinciding with a very busy deal environment. And even simple amendments here can take time. Waiting to tie the LIBOR amendment into a potential upcoming transaction amendment addressing deal terms may prove to frustrate the timing of the deal term amendment, further annoying a client.

Practical Solutions. There are some deals where the Borrower's need for multicurrency borrowings is a nice to have, not a need to have. Make sure your Fund CFO knows that removing the ability to borrow in currency is a pragmatic approach, albeit at a loss of flexibility, that can avoid the need for major surgery on the currency provisions in the credit agreement. We are seeing this approach used where it is possible, particularly in older deals where the Funds are later in the lifecycle.

The Syndicate. The lead bank should affirmatively reach out to the syndicate members prior to commencing the amendment preparation, particularly in multicurrency deals. Not all banks are equipped to support every new interest rate benchmark. Identifying these type of challenges early in the process and not during the comment phase can be very helpful.

Borrower Comments. Help your Fund CFO understand the comment environment. Banks are undertaking a massive project implementing these changes throughout their entire portfolio of all LIBOR-based asset classes – in many cases, literally thousands of distinct loans. Each bank's standardized provisions are typically coming from a centralized LIBOR task force (and not from the Fund Finance team or its law firm), and there are often material differences in approach between banks. Each convention and, often times, each word in new benchmark provisions has been extensively vetted by each bank's internal teams (legal, risk, operations, IT, swaps teams, pricing) over the course of many months in order to develop standard provisions that work in the requisite environment. Thus, each bank naturally has an institutional preference for conformity and consistency with its policies. Like always, we fully respect Fund borrowers' right to comment, and they should comment on all language as they see appropriate. But comments on LIBOR succession have to be run through many more levels of approval than typical transactional terms: Changes have to go through, for example, the bank's centralized LIBOR team as well as, at times, even IT Systems teams (to ensure any requested changes are actually possible from a new IT systems and software perspective). And, in a syndicated deal, this is true for every bank in the syndicate. Bank receptivity to comments in this area is not surprisingly less accommodative than on commercial issues within the decision rights of the Fund Finance deal teams – banks are far more resistant to change in this area to ensure a consistent standard that they as an institution will be able to both implement and live up to. Thus, managing comments here requires far more time and expense than typical. Borrowers should be informed of this expressly so they understand the correlation in this context with costs and time as they make decisions on whether a particular comment is a must have, nice to have or not necessary. A Fund CFO not advised on this reality will end up frustrated.

Legal Teams. Banks should encourage their law firms, and encourage their Fund CFOs to encourage their own law firms, to form dedicated teams that include senior members of both the applicable deal team and any needed LIBOR transition specialists. Many deal lawyers know the LIBOR transition issues at a high level, but often not as to every applicable currency, nuance or operational difference. LIBOR specialist lawyers, in turn, do not necessarily know the intricacies of the particular bank and transaction. Cross-staffing expertise may be required in certain circumstances. Additionally, the substantive changes here are in places highly complex, and it cannot be competently handled by incoming first-year lawyers, for example. Let's get the teams right.

Consummation. When the amendment consummates, the relationship manager at the bank should call and thank the client. While this was nobody's fault, the Fund will have allocated real time and cost to the project. Let them know it is appreciated and ask for feedback – we should all be trying to learn and make the process more efficient each time as we go forward. Give your law firms feedback as well.

Conclusion. I really see this as an area with the potential to have material negative impacts on your client relationships if handled incorrectly. We should all do the best we can to try and head that off. If anyone has any further suggestions for how to drive efficiencies in the process, I would welcome them.