

CADWALDER

Current State of Play of Alternative Currency Benchmark Rates

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As we finish the last season of LIBOR replacement, the fund finance market is busy amending our loan documents to include SOFR as the interest rate benchmark for U.S. dollar loans. While the cessation date for USD LIBOR is June 30, 2023, the deadlines for the continuing IBOR benchmarks for other currencies are more of a mixed bag. In this piece we analyze the current state of play of the alternative currency benchmark rates to equip you with the information you need to assess their use in your facility documentation.

How Did We Get Here?

Before delineating where we are and where we're going, let's briefly discuss where we've been. The stoppage date for the LIBOR-quoted currencies other than U.S. dollars was December 31, 2021. Since then, the global financial markets have generally referenced their new replacement rates. For euros, there's EURIBOR and €STR. For sterling, SONIA has become the standard. Japanese yen is now tied to TIBOR and TONAR. And Swiss francs is linked to SARON. This article expounds on each and elucidates the goings-on of nine other commonly used currencies' fallback rates: Australian dollars, Canadian dollars, Danish krone, Hong Kong dollars, Mexican pesos, New Zealand dollars, Norwegian krone, Singapore dollars and Swedish krona.

The key driver of change was to ensure any interest rate benchmark on which loans and other financial products are based remains representative, reliable and robust. Central banks, regulators and administrators of each currency benchmark have stressed the importance of these criteria to maintain the systemic integrity and stability of the world's financial sectors. A benchmark should be representative of the underlying deals in which it is used to remain relevant as a reference rate. It needs to reliably yield a consistent result across time and transactions to instill trust from market participants. It requires robustness to prevent instability through adverse market scenarios, such as pandemics, financial crises, inflation, interest rate hikes and geopolitical unrest. These factors were core to the selection by the relevant governmental authorities of the benchmarks analyzed in this article.

To strengthen the interbank offered rates, benchmark administrators sought to increase the number of transactions on which they were anchored and to improve the processes and controls for submission of rate calculations by expert panel banks. In parallel, regulators identified and developed risk-free rates, or RFRs. These benchmarks generally are underpinned by a vastly larger volume of measurable trades and so may be more representative and reliable. Jurisdictions where an interbank offered rate was bolstered while an RFR was constructed are said to have taken a "multi-rate approach." Certain currencies couldn't support a multi-rate approach due to the thinness of the funding markets on which their benchmarks were based. In such situations, the IBOR either has been or will be phased out in favor of a new RFR, as detailed further below.

Where Are We Now?

Because most markets have historically tied interest to term rate benchmarks, authorities in several jurisdictions have opted to reform the calculation and administration of the applicable term rate IBOR to complement the use of the relevant RFR. That multi-rate approach is currently in use for euros, Japanese yen, Australian dollars, Hong Kong dollars, New Zealand dollars and Swedish krona. In England and Switzerland, government regulators moved directly from LIBOR to the new risk-free rates of SONIA and SARON, respectively, without retaining a multi-rate approach.

Euros

Regulators in the eurozone have chosen to maintain EURIBOR, the Euro Interbank Offered Rate, as a viable benchmark for euros despite the global trend of phasing out legacy benchmarks. EURIBOR is referenced in roughly €180 trillion of contracts, and its use in a vast array of financial products has prompted regulators to reform the methodologies of how it is calculated to maintain its existence. EURIBOR is now considered compliant under the EU Benchmark Regulation, but there are recommendations to use €STR, the Euro Short-Term Rate, as a risk-free rate fallback in case of contingency events. It is not clear whether EURIBOR will remain available permanently or if market participants may gradually turn to a risk-free rate such as the €STR. The reformed EURIBOR is expected to remain in existence until at least the end of 2025, and it remains the dominant benchmark for euros in fund finance facilities.

€STR was developed to measure the wholesale euro unsecured overnight borrowing costs of euro area banks, taking borrowing activity beyond the interbank segment into account. The rate is based on structurally stable bank trades and reduces the influence of the credit element. The eligible transactions to compute €STR were narrowed down to those executed by reporting banks as fixed-rate overnight deposits placed by financial institutions. €STR is then calculated as a volume-weighted trimmed mean of the eligible transactions, and a contingency formula is used when there is insufficient underlying data. The Euro RFR working group is developing forward-looking term rates based on €STR, but it is unclear if or when that will be made available. Until then, most fund finance facilities that utilize €STR reference it as a daily compounded rate.

Japanese Yen

Historically, there were two possible IBORs that could be used for Japanese yen: Japanese Yen TIBOR and Euroyen TIBOR. After public consultation, the Japanese Bankers Association, JBATA, chose to maintain Japanese Yen TIBOR because it is an interest rate benchmark in a far greater number of contracts globally while Euroyen TIBOR will be phased out. JBATA has been conducting further consultations on fallback issues for Japanese Yen TIBOR, but for now it continues to be the major rate in fund finance deals for Japanese yen.

TONAR, the Tokyo Overnight Average Rate, is an alternative reference rate that is gaining traction in certain sectors of the financial industry. As a daily risk-free rate, TONAR is calculated by the Bank of Japan based on the weighted average of interest rates charged by major financial institutions for overnight loans in the Japanese interbank market. Some fund finance facilities that reference other daily risk-free rates like SOFR and SONIA may currently contain TONAR for consistency of approach on interest rate across loan types. TORF, the Tokyo Term Risk Free Rate, is a term risk-free rate benchmark that is supported by the public consultations conducted by the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks. TORF is based on the uncollateralized overnight call rate and involves almost no credit risk of financial institutions, and as a term rate it is fixed as of the start of the interest rate calculation period. Only time will tell if TORF ultimately gains traction in our industry, as TIBOR maintains its usage in fund finance due to its historical familiarity and current status by Japanese regulators as a viable multi-rate option.

Australian Dollars

Australian governmental supervisors have been working closely with currency administrator ASX and financial market players to ensure that BBSW, the Bank Bill Swap Rate, and BBSY, the Bank Bill Swap Bid Rate, each remains robust. Both are a credit-based interest rate benchmark traditionally used for Australia dollars in fund finance facilities and there are no plans by their regulators to discontinue their use. A multi-rate approach is being adopted in Australia where BBSW and BBSY will coexist with the risk-free rate AONIA, the Australian Overnight Index Average. It is calculated daily by the Reserve Bank of Australia as the weighted average of actual market transactions on unsecured overnight loans between banks. AONIA provides a reliable alternative to the older benchmark rates, but it has not seen a significant uptake in fund finance deals as industry actors have kept with the more familiar BBSW and BBSY.

Hong Kong Dollars

HIBOR, the Hong Kong Interbank Offered Rate, is a well-established benchmark used in the fund finance space. It is calculated based on quotations from 20 designated banks with a presence in Hong Kong. HIBOR is widely recognized as credible and reliable, and there are no plans to discontinue it. HONIA, the Hong Kong Overnight Index Average, has been identified as a fallback reference rate to be offered in a multi-rate approach with HIBOR. HONIA is an unsecured overnight lending rate calculated based on data submitted by participating banks and executed through a panel of five contributing brokers. HONIA is published each business day and is considered a potentially valuable tool for financial institutions due to its daily calculation, wide coverage and robust methodology, but has not been yet supplanted HIBOR as the interest rate of choice for Hong Kong in our deals.

New Zealand Dollars

BKBM, the Bank Bill Benchmark Rate, has long maintained its status as the interest rate benchmark for New Zealand dollars in fund finance. That's not expected to end any time soon. The New Zealand Financial Markets Association has made changes to improve the benchmark's reliability and robustness in line with global best practices, including capturing data from live trading platforms and selecting OCR, the Official Cash Rate, as the risk-free fallback benchmark for BKBM. BKBM represents the mid-rates for prime bank eligible securities traded in the local New Zealand market. It represents the rates at which banks are willing to lend or borrow from each other for terms of one to six months. The New Zealand Financial Markets Association intends to operate dual interest rate benchmarks, retaining BKBM while administering OCR as the risk-free base rate. The OCR Compound Index is a backward-looking

rate based on OCR that is compounded daily in arrears over the relevant period. The New Zealand Financial Markets Association provides a history of the OCR Compound Index on its website along with a calculator to determine NZONIA, the New Zealand Overnight Index Average, which is a term risk-free rate in arrears. Yet BKBM currently continues to be the chief rate for New Zealand dollars in fund finance transactions.

Swedish Krona

STIBOR, the Stockholm Interbank Offered Rate, is the historical reference rate of choice in fund finance and other financial products offering Swedish krona. It is administered by the Swedish Financial Benchmark Facility, which has worked to adapt STIBOR to all requirements and regulations applicable to reference rates and critical benchmarks. STIBOR is based on banks' financing costs and thus reflects actual transactions in Swedish krona. The method used to calculate STIBOR is currently being further reformed to link a larger set of transaction types to enhance its future usability. The alternative risk-free option is SWESTR, the Swedish Krona Short Term Rate, which has been developed based on a recommendation by a market-led working group under the purview of the Swedish Bankers' Association. SWESTR is a short-term reference rate that could eventually be used as the primary rate in place of STIBOR in our financial agreements, but any transition from STIBOR to SWESTR would likely take several years to implement and is not currently definitive.

Sterling

SONIA, the Sterling Overnight Index Average, has been used as the benchmark for Great British pounds in virtually all fund finance contracts since the end of 2021. It's based on actual transactions that reflect the average interest rate banks pay to borrow sterling overnight from other financial institutions and investors. The Bank of England is the administrator for SONIA and is responsible for its governance and publication every London business day. SONIA is referenced in over £90 trillion of new transactions each year and complies with international best practices for financial benchmarks. SONIA is measured as the trimmed mean of interest rates paid on eligible sterling-denominated deposit transactions. While for trades in Europe it is predominantly calculated using a compounded in arrears methodology, fund finance transactions in the United States have most commonly implemented it as a daily rate to track a similar procedure for how daily simple SOFR is calculated. The regulators in England have signaled that Term SONIA is only applicable in a very limited number of use cases and would not apply to loans offered in our fund finance facilities.

Swiss Francs

SARON, the Swiss Average Rate Overnight, is a benchmark that represents the overnight interest rate of the secured money market for Swiss francs. It is determined from transactions and quotes posted in the Swiss repo market, which is a crucial part of the Swiss fiscal sector. The rate is a daily risk-free rate calculated and published by SIX, its benchmark administrator, and is highly regulated under the Swiss Financial Market Infrastructure Act. SARON has been noted as particularly suitable for secured loans due to its low counterparty and liquidity risks, and is seen as having low volatility to changes in bank confidence levels and during turbulent market phases. There is no expectation that forward-looking term rates based on SARON will develop, and the National Working Group on Swiss Franc Reference Rates is not pursuing them. As such, SARON is expected to continue as the benchmark in fund finance and other forms of financial transactions.

Where Are We Going?

While the interest rate benchmarks for the currencies listed above should not vary in the foreseeable future, change is afoot for other mediums of exchange. Canadian dollars and Singapore dollars will see their current benchmarks phased out, and there is less certainty with how long the current benchmarks may be retained for Danish krone, Mexican pesos and Norwegian krone.

Canadian Dollars

CDOR, the Canadian Dollar Offered Rate, is the benchmark established in Canada for bankers' acceptances and is based on a survey of bid-side rates provided by six principal Canadian market-makers. Although it has long been the benchmark for Canadian dollars in fund finance, the Canadian Alternative Reference Rate Working Group concluded that CDOR's architecture poses risks to its future viability and robustness. Accordingly, Refinitiv Benchmark Services Limited, the CDOR benchmark administrator, has stated it will cease publication of all remaining tenors after the end of June 2024.

Enter CORRA, the Canadian Overnight Repo Rate Average. It's the risk-free rate based on overnight funding in Canadian dollars using government treasury bills and bonds as collateral for general repo transactions. The Bank of

Canada has administered CORRA since June 15, 2020. In response to the phase out of CDOR and a desire for a Canadian dollar term rate, efforts are underway to develop a one- and three-month Term CORRA benchmark. It will be derived from completed transactions and executable bids and offers for CORRA interest rate futures traded on the Montréal Exchange and is expected to be usable for loans of the type we see in fund finance. Most in our industry have still maintained CDOR in our contracts and have yet to hardwire CORRA as a fallback. But it is expected that CORRA will be more frequently implemented as a specified replacement rate in our deals once we're within a year of the June 2024 deadline for CDOR cessation.

Singapore Dollars

SIBOR, the Singapore Interbank Offered Rate, is an estimate of the rate that one bank would have to pay another bank to borrow Singapore dollars. It is based on daily submissions from a panel of contributor banks, but may not always reflect actual transactions. SIBOR is the interest rate benchmark classically used for Singapore dollars in fund finance trades.

In contrast, SORA, the Singapore Overnight Rate Average, is the volume-weighted average borrowing rate in the unsecured overnight interbank cash market based on actual transaction data and published daily on the Monetary Authority of Singapore's website. In December 2020, the Steering Committee for SOR & SIBOR Transition to SORA was created to oversee the transition from SIBOR to SORA. The aim is to create a more unified and liquid market, with more transparent pricing for borrowers and improved interest rate risk management for lenders. SIBOR will be discontinued after December 31, 2024. Fund finance practitioners have largely maintained their use of SIBOR for now, but should look to stop using it in new contracts that may go beyond the end of 2024.

Danish Krone

The current reference rate for Danish krone is CIBOR, the Copenhagen Interbank Offered Rate. It has been the standard benchmark used in our fund finance facilities over time and Danish regulators have not yet imposed an obligation that it be replaced. However, governmental authorities in Denmark considered it important for their financial system to introduce a short-term transaction-based reference rate for Danish krone, in line with international standards. The central bank Nationalbanken is the administrator of the new risk-free reference rate DESTX, the Denmark Short-Term Rate. It was launched in 2022 after a testing period in 2021. DESTX is founded on overnight borrowing transactions of one-day money market rates collected from a broad bank group. The new statistic is expected to be extended to a wider range of foreign exchange transactions in the future, including for revolving loan facilities. Nationalbanken is developing a working group with participation from the Danish banking sector to prepare a proposal for the transition from and potential discontinuation of CIBOR. But for now, CIBOR continues as the interest rate benchmark of use for Danish krone deals.

Mexican Pesos

TIIE, the Interbank Equilibrium Interest Rate, is the benchmark used for Mexican pesos in the fund finance transactions offering that currency. Like with the other interbank offered rates, it is calculated using commercial bank quotes by Banco de México rather than on a robust set of actual peso trades. The development of a market tied to Overnight TIIE, the Mexican risk-free rate, is being encouraged by the National Working Group on Reference Rates. After the Mexican government issued bonds referenced to Overnight TIIE in October 2021, some other financial institutions have also started issuing debt linked to the new RFR, but we have yet to see it in our fund finance deals. The analysis to discontinue the use of previous term TIIE is in progress by Mexican authorities and there have been public discussions of a possible cessation after 2024 for all tenors. Having said that, the National Working Group is also exploring if it would be more appropriate to instead change the methodology of the Mexican interbank offered rate TIIE to permit its ongoing use based on its legacy in contracts. It is uncertain if Overnight TIIE will ever overtake historical TIIE for use in fund finance and the global markets for Mexican pesos generally.

Norwegian Krone

The current reference rate in Norway is NIBOR, the Norwegian Interbank Offered Rate. While it is still in use for Norwegian krone in our deals, its future is less determined. In September 2019, the Norwegian governmental working group recommended a version of NOWA, the Norwegian Overnight Weighted Average, which is a risk-free rate that can be used for loan transactions. While NOWA has been published since January 2020, NIBOR is not expected to cease in the short term. Instead it is anticipated that NOWA and NIBOR will be used in parallel for now as a multi-rate market approach. Institutions may eventually need to plan for a transition from NIBOR to NOWA if NIBOR is no longer

published. But there are material differences between the rates, and so an inception of NOWA as the primary benchmark is not close to being guaranteed at this point.

Conclusion

While there is certainty with some alternative currency benchmark rates in fund finance deals for the foreseeable future, others will definitely see change occur. When there are material updates that may impact your transactions, we will continue to publish guidance for how you can implement the appropriate benchmarks.

Sovereign Immunity – Cayman Islands

April 21, 2023



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We have been following *Fund Finance Friday*'s journey through different **U.S. jurisdictions** (and last week's look at **England & Wales**) and the interesting range of approaches taken by various states to sovereign immunity. With the Cayman Islands being the largest offshore fund domicile for U.S. fund managers, we thought it was worth extending the series offshore.

In the Cayman Islands context, the immunity question usually comes into play during borrowing base diligence, where the investor's side letters and subscription documents are governed by Cayman Islands law (not uncommon for large sovereign or sovereign-linked investors who invest via an offshore feeder or alternative investment vehicle).

As a British Overseas Territory, the United Kingdom's State Immunity Act 1978 (the "Law") extends to the Cayman Islands by statutory order. Immunity generally applies to the head of state, the government of any state and any department of that government, but not to a "separate entity" distinct from the executive organs of the government that can sue and be sued. Whether or not an investor is a "separate entity" can be a complex and highly fact-specific question. Considerations include the degree of autonomy, governance structure, and legal form of the entity (among other factors). As a conservative starting point, it would be safe to proceed on the assumption that a sovereign-linked investor (such as a government pension plan or sovereign wealth fund) could be held to be a department of government rather than a "separate entity" and therefore subject to immunity from legal proceedings.

When analysing a lender's recourse to the investor, a key useful exception under the Law is the "commercial transaction" exception. This exception excludes immunity for, among other things:

- a loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation; and
- any other transaction or activity (whether of a commercial, industrial, financial, professional or other similar character) into which a State enters or in which it engages *otherwise than in the exercise of sovereign authority*.

If the investor is a special purpose investment vehicle, this also points towards the entity engaging in commercial activity as opposed to exercising sovereign authority, meaning that the exception is more likely applicable. This follows case law stating that an entity's separate corporate status should be respected when examining the scope of any immunity.

By contract, it's possible to waive immunity for legal proceedings in the Cayman Islands, and side letters may contain such waivers (either fully or on a more limited or caveated basis). Just as frequently, a side letter may expressly preserve any immunity enjoyed by the investor in question. It is also possible to expressly contract out of the "commercial transaction" exception above. Any side letter immunity language must therefore be carefully reviewed to assess whether immunity has been waived or if it does operate to limit or obviate the commercial transaction exception.

Thanks to *Fund Finance Friday* for letting us add the Cayman Islands' perspective to the sovereign immunity series.

WSJ Covers Credit Demand for Subscription

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Subline demand vastly outstrips credit availability, according to a *Wall Street Journal* article this week titled “**Bank Pullback Leaves Buyout Firms Starving for Bridge Loans**.” The article highlights lenders that have retreated from the market. It’s also the first time we can recall seeing subscription facility margins explicitly quoted in a mainstream news article. Facility margins of around 300 bps affects the way funds use credit facilities, according to the article.

WFF Hosts Successful Wit and Wisdom Program in Charlotte

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Women in Fund Finance (WFF) hosted its inaugural Wit and Wisdom Event in Charlotte earlier this week. The Wit and Wisdom events are designed to bring together young professionals with senior women for discussions on a range of topics in the fund finance industry, ranging from office politics to avoiding feeling stuck and anything in-between.

The event, which was targeted toward junior to mid-level women in the industry, was held at Haynes and Boone's new Charlotte office space, and provided those in attendance with an intimate atmosphere that encouraged relatable questions and candid conversations with the panelists.

The discussion was moderated by Erin Goldstein (Wells Fargo) and included panelists Jill Dinerman (Barings), Karrie Jerry (Axxes Capital), Caroline Dallas (Global Endowment) and Christine Carter (Mayer Brown). The unique background and experiences of each panelist offered insight into career changes, how to take on different roles within the workplace and when to step up as a leader. Each highlighted the importance of staying challenged and loving what you do.

Thank you to the event sponsors: Cadwalader, Haynes and Boone, Mayer Brown and Wells Fargo. We look forward to the next Wit and Wisdom Event with WFF.

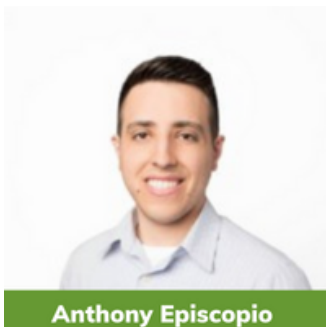
On the Move – Fund Finance Tidbits

April 21, 2023

On the Move



Olawale Ajayi has recently joined CA-CIB in London as the Vice President in Private Equity Funds Solutions. As a member of the global team, he will continue to provide capital call financing and NAV-based lending to investment funds. Olawale was previously at Bank of China, where he helped start their subscription lending business in London, which focuses on financing solutions in the alternative fund space. Prior to Bank of China he was at HSBC in the Leveraged Finance Portfolio team.



Anthony Episcopio has recently joined Apple Bank in New York as a Vice President in Subscription Finance, where he will continue to underwrite and structure subscription credit facilities for leading private equity funds. Anthony was previously at Signature Bank, focusing on financing solutions in the alternative fund space.

Cadwalader Adds Leading Specialty Finance and Securitization Partner Ryan McNaughton

April 21, 2023



Structured finance partner Ryan McNaughton has joined Cadwalader's market-leading securitization and structured finance practice in New York. Ryan joins Cadwalader from King & Spalding.

Ryan represents banks, broker-dealers and other financial institutions and private equity and asset management firms as issuers, underwriters, lenders and investors in structured and corporate finance transactions, securities offerings (public and private) and credit facilities. Ryan has a particular focus on esoteric asset-backed securities (ABS), including asset classes and transactions such as whole business and other operating asset securitizations, music and media royalty transactions, oil and gas interests, franchise concepts, digital infrastructure, cell towers, data center and distributed antenna operators, solar and renewable energy assets, transportation assets, outdoor advertising receivables, ground leases, and specialty real estate lending transactions.

Ryan's addition expands Cadwalader's leveraged and acquisition finance capabilities, as he regularly advises private equity and asset management firms and investors in the structuring, diligence and execution of asset-based acquisition financings and related warehousing and securitizations. Ryan will be reunited with his former colleagues Ronald Lovelace, Patrick Yingling, Jared Zajac and Joseph Polonsky, a market-leading leveraged finance team from King & Spalding that also recently joined Cadwalader, and who had all worked closely with Ryan in executing some of the largest whole business securitizations and novel structured leveraged finance transactions in the market. Over the last decade, Ryan has been opposite Cadwalader partners Stuart Goldstein and Ira Schacter on several novel securitization transactions, and was well aware of Cadwalader's place as one of the pioneers in the development of using structured finance and securitization as a corporate financing tool.

"We are very excited to have Ryan join our firm," said Cadwalader managing partner Pat Quinn. "We are already considered the dominant transatlantic firm in structured finance. Ryan's arrival will significantly enhance our existing capabilities and strengthen our first-rate ABS practice."

Added Capital Markets co-chair Stuart Goldstein: "Ryan will be instrumental in expanding our capital markets and corporate finance capabilities – particularly important in today's environment, as clients continue to seek innovative ways to finance M&A and other transactions. We are excited to grow our team with Ryan and his market-leading practice."