



THE SHIFT FROM LIBOR: THE NIGERIAN PERSPECTIVE

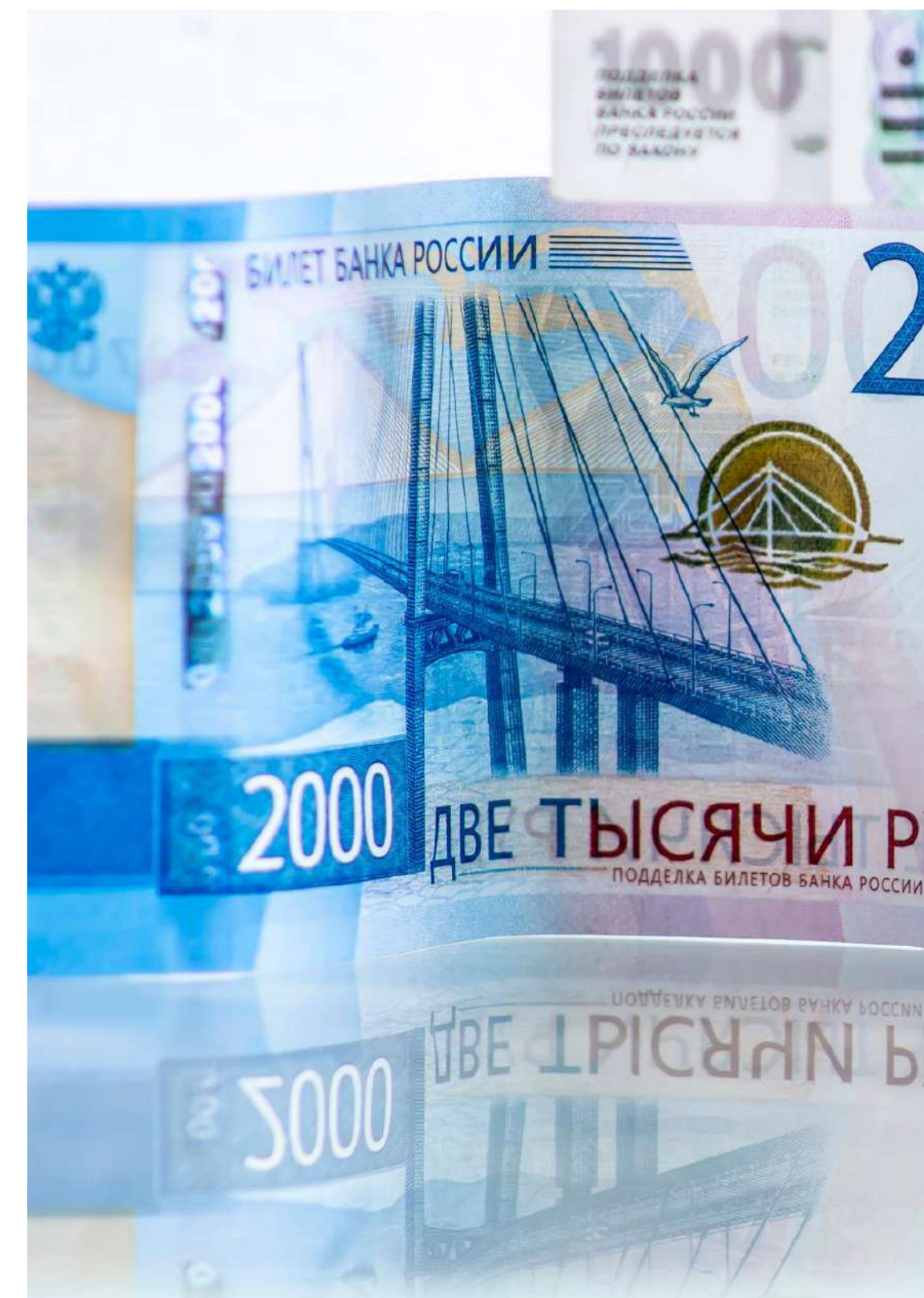
The London Interbank Offer Rate (LIBOR) is an internationally accepted forward-looking benchmark interest rate that indicates lending costs between...

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1. WHAT HAS HAPPENED

The London Interbank Offer Rate (LIBOR) is an internationally accepted forward-looking benchmark interest rate that indicates lending costs between banks and is published daily by ICE Benchmark Administration Ltd via the Intercontinental Exchange. Despite a track record of about forty (40) years, LIBOR is being phased out due to issues around its validity as a benchmark rate.

The final date of publication of LIBOR is 30th June 2023 (as confirmed by the United Kingdom's Financial Conduct Authority). This is however solely in respect of the United States Dollar (USD) LIBOR as other currency (Sterling, Euro, Swiss franc and Japanese yen) LIBOR settings have been phased out since 31st December 2021.



2. THE RISK-FREE RATE WAVE

The transition out of LIBOR is leading many financial market stakeholders to switch to alternate risk-free rates (RFR). Switching from LIBOR (an interbank offer rate) to a RFR is likely to cause significant market disruption as unlike LIBOR, RFRs are generally backwards-looking rates.

The replacement RFRs notably differ from currency to currency:

LIBOR SETTING	REPLACEMENT RFR ¹
USD LIBOR	Secured Overnight Financing Rate (SOFR)
European (EUR) LIBOR	Euro Short-Term Rate (€STER) (replaced the Euro Overnight Index Average Rate in 2022)
British Pound Sterling (GBP) LIBOR	Sterling Overnight Index Average (SONIA)
Swiss franc (CHF) LIBOR	Swiss Average Rate Overnight (SARON)
Japanese Yen (JPY) LIBOR	Tokyo Overnight Average Rate (TONA)

1. This is a list of some available rates. There are other available replacement rates for the relevant LIBOR setting.



3. THE WAY FORWARD FOR THE NIGERIAN FINANCIAL MARKET

A. Financial Considerations

Considering the fact that a considerable volume of foreign loans in Nigeria are denominated in USD, there is a consequential focus and emphasis on the replacement RFRs for USD LIBOR, particularly SOFR being the common replacement rate.

SOFR is published by the Federal Reserve Bank of New York and can be:

- (i) **Daily Simple SOFR:** This is calculated daily, using simple interest over the current interest period and multiplied by the outstanding principal of the loan; or

(ii) **Daily Compounded SOFR:** This is calculated in arrears or in advance. Where calculated in arrears, the interest rate is compounded over the current interest period and is not known prior to the payment date. If in advance, the rate is calculated by compounding interest over a previous period (i.e. tenors of 30, 90 or 180 days) and is known before the start of the interest period.

(iii) **Term SOFR:** This is a forward-looking SOFR and is developed based on actual SOFR future transactions. It has one-month, three-month, six-month, and 12-month tenors. Term SOFR is known in advance of the start of the interest period and is the easiest to operationalize because it functions like LIBOR. Term SOFR is considered by many market participants to be the preferred SOFR variant for loans.



Alternatives to SOFR include:

(i) **American Interbank Offered Rate** which is suitable for secured lending and is created from transactions observed on the AFX;

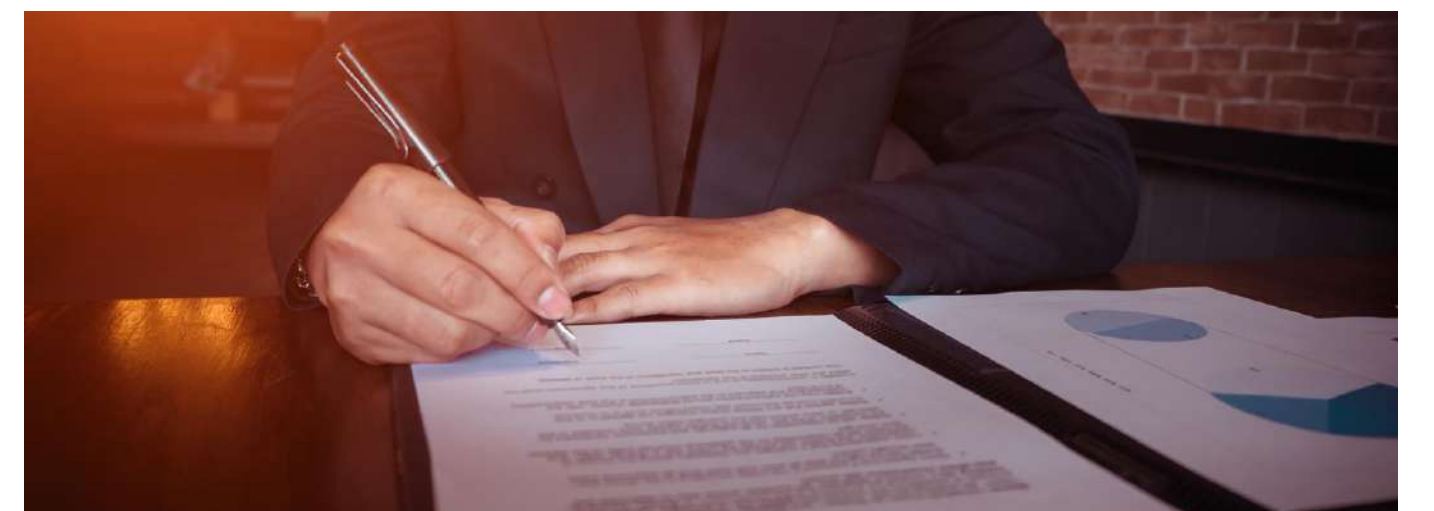
(ii) **Bloomberg Short-Term Bank Yield (BSBY) Index**, a proprietary index calculated daily and constructed from observed transactions on Bloomberg's proprietary trading platforms as well as from feeds from the Financial Industry Regulatory Authority (FINRA).



B. Contractual Considerations

(i) **Review and Amendment of Finance Documents:** It is key for financial institutions to undertake a full review of finance documentation for all legacy transactions to ascertain the amendment provisions and fall back provisions in finance documents that may cater to the occurrence of the LIBOR transition event (if any). Such provisions include clauses on market disruption events.

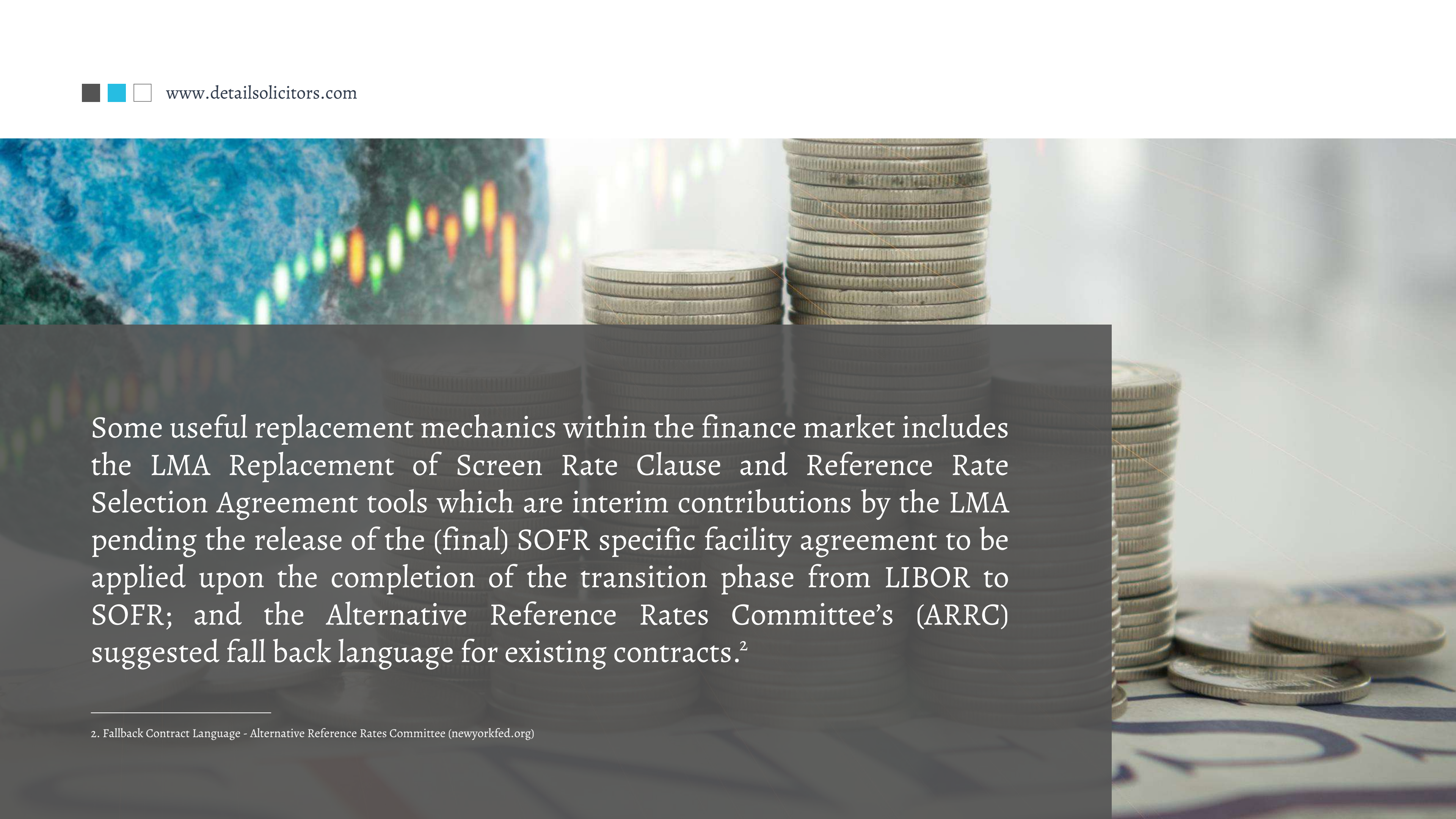
Also, in order to adequately reflect the transition from LIBOR to a RFR, parties to legacy transactions will be required to amend the terms of their finance documents to reflect the chosen replacement rate, method/basis of calculation of rate, any changes to payment schedules and other incidental matters. Amendments can be effected using relevant documents.





(ii) **Inclusion of Fall-Back Provisions in Existing and New Contracts:** Owing to the prior prevalence of the LIBOR, some legacy agreements may not contain fall back provisions (i.e. adequate market disruption clauses) which envision the discontinuation of LIBOR or transition to an alternative rate, thereby rendering them impracticable. Also, parties may face tougher negotiation meetings in deciding a replacement rate.

Given the closeness of the deadline for the LIBOR transition, finance documents' templates (particularly by the Loan Market Association (LMA)) have been updated and published. Specific efforts have been made in these templates to cater for the transition from LIBOR to an alternative rate as well as fall back provisions.



Some useful replacement mechanics within the finance market includes the LMA Replacement of Screen Rate Clause and Reference Rate Selection Agreement tools which are interim contributions by the LMA pending the release of the (final) SOFR specific facility agreement to be applied upon the completion of the transition phase from LIBOR to SOFR; and the Alternative Reference Rates Committee's (ARRC) suggested fall back language for existing contracts.²

2. Fallback Contract Language - Alternative Reference Rates Committee (newyorkfed.org)


(iii) **Third-Party Security Impact:** In finance transactions where security such as undertakings or guarantees have been provided by an obligor as credit enhancement, the consent of third-party security providers may be required for amendment of finance documents and/or change of interest rate.



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