

# **Servicers gain authority to switch from Libor in some ABS, legacy bond issue not addressed**

by John Wilen | 31 January 2019

Credit card ABS issuers last year began including language in their deal prospectuses that gives the servicer — which is typically also the issuer — authority to shift the deal’s benchmark from Libor to a replacement rate, according to the deal documents, securitization lawyers and SFIG officials.

The language will allow servicers and trustees to side-step the messy and lengthy process of gaining bondholder consent for prospectus amendments.

However, the new prospectus language limits the servicers’ discretion to very narrow criteria, leaving open, for instance, the question of what a servicer is allowed to do if Libor continues to be published past its expected end date in a “zombie” form supported by fewer submitting banks.

Also, the prospectuses generally don’t address servicer indemnification, potentially leaving the servicers open to legal action from investors who disagree with their rate-change decisions.

Similar language has also been used in some recent RMBS deals and in some non-US auto ABS transactions, according to Julie Gillespie, an attorney at Mayer Brown. However, it is unlikely to emerge as an ABS industry template, as third-party servicers will likely be reluctant to agree to be the party who decides when a deal should switch rates, said Kristi Leo, head of investor policy at the Structured Finance Industry Group.

“When you’re talking about a third-party servicer, they do not want that responsibility,” Leo said.

The new language was pioneered by Citi, in July. Since then, Discover, American Express and Barclays’ Dryrock platform have all adopted versions of language that gives their deals’ servicers the authority to switch from Libor to an alternative rate if the servicer determines that Libor has been discontinued or is no longer being published.

## **Different triggers**

There are variations between the deals. For instance, Citi's trigger is a determination by Citibank or an affiliate "that Libor has been discontinued or is permanently no longer being published," according to a representative prospectus. In such an instance, the trust will use a "substitute or successor base rate that Citibank (or one of its affiliates) has determined, in its sole discretion" is either the industry-accepted replacement base rate, or, if there is no such industry-accepted replacement rate, a rate "that is most comparable to Libor."

Amex prospectus language adopted in September allows a rate change if the servicer determines that Libor "has been discontinued." Like Citi's language, however, the servicer is then directed to use an alternative rate selected by industry consensus, or, if no such replacement rate has been identified, to "in its sole discretion, determine the alternative rate and make any adjustments thereon, which determinations will be binding on the trustee and investors."

Dryrock prospectus language adopted in September allows the servicer to switch to a new benchmark if Libor "has been discontinued or is permanently no longer being published," but only if there is an industry-accepted substitute. If there is no industry-accepted substitute rate, then Dryrock deals will continue to reference the last published Libor level.

Discover prospectus language adopted in October differs more than the others. It allows the servicer to switch benchmark rates in one of two circumstances:

- The "calculation agent" — which is Discover — "determines in its sole discretion that Libor has been discontinued or is no longer being published"; or
- A public statement has been made on behalf of ICE Benchmark Administration, which administers Libor — including by the Financial Conduct Authority, ICE's regulator — that ICE will stop providing Libor, that the number of bank submissions to Libor has fallen below "the number required by [ICE's] internal policy," or that "Libor may no longer be representative or may no longer be used."

Like the Citi and Amex prospectus language, Discover's allows the servicer in these circumstances to switch the deal to a new industry-accepted rate, or, if there is no industry-accepted rate, to choose an alternative rate "in its sole discretion after consulting any source it deems to be reasonable as a substitute for Libor."

## **What about 'zombie' Libor?**

The language does not address what servicers are authorized to do if Libor is still being published past the end of 2021, when the Financial Conduct Authority's agreement with 20 panel banks that submit the daily rates used to calculate Libor ends. As reported, ICE is working with panel banks and other Libor "stakeholders" to ensure that the benchmark lives on in some form after that agreement ends.

The prospectus changes to date also do not address the potential that servicers could face liability for their decisions. “So far we are not seeing this type of indemnification language, but we may see this in the future as the Libor replacement language continues to develop,” Gillespie said.

So far, prospectus language giving servicers the authority to switch rates has only appeared in new transactions. “We have not seen any attempt to amend legacy transactions, because it is not typically practical to obtain the required noteholder vote,” Gillespie said.

Getting the 100% noteholder consent needed to give a legacy deal’s servicer the authority to change rates is likely “impractical ... particularly when the replacement rate remains unknown,” she said.

As reported, most industry efforts underway at the moment to address the Libor transition deal with new transactions. SFIG will begin working with the industry to develop a consensus approach to legacy transactions this quarter, Leo said.

“Right now there’s clearly no industry consensus on how to deal with legacy deals,” Leo said.