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Transitioning from LIBOR: Legal Considerations for the Nigerian Financial Market

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The global financial services industry is in the process of transiting from the utilization of the London Interbank Offered Rate ("LIBOR") benchmarks. Accordingly, borrowers and lenders across the globe are navigating the transition from LIBOR to risk-free rates ("RFRs"). The Nigerian financial market is not excluded from this transition.

In Nigeria, LIBOR is used in both local and cross border lendings, many of which will be affected by the transition. With the impending end of LIBOR, it is therefore important for contractual parties in the Nigerian financial market to consider alternatives to LIBOR, the legal implications and challenges for a LIBOR transition in Nigeria, and recommendations for a successful transition. However, for facilities where the currency of the transaction is the Nigerian Naira, the cessation of LIBOR poses no issue as the reference rate will remain the Nigerian Interbank Offered Rate ("NIBOR") or other agreed benchmark.

Alternatives to LIBOR: Risk Free Rates

RFRs are benchmarks generally based on overnight deposit rates. For each currency for which LIBOR is currently published, a risk-free rate has been identified. Regulators and working groups in the home jurisdictions of each of the five LIBOR currencies have identified the preferred RFR for their local currency, each of which is now published, as shown in the following table (overleaf).

Currency	Approved RFR	Administrator	Secured or Unsecured
US Dollar	SOFR (Secured Overnight Financing Rate)	Federal Reserve Bank of New York	Secured
Sterling	SONIA (Sterling Overnight Index Average)	Bank of England	Unsecured
Euro	€STR (Euro Short-Term Rate)	European Central Bank	Unsecured
Swiss franc	SARON (Swiss Average	SIX Swiss Exchange	Secured
Japanese yen	TONA (Tokyo Overnight Average Rate)	Bank of Japan	Unsecured

RFRs are preferred to Interbank Offer Rates (IBORs such as LIBOR) for two principal reasons:

a. RFRs are based on deep, highly liquid, overnight borrowing markets; and

b. RFRs are calculated by reference to recorded transactions in those markets, rather than relying on submissions from panel banks.

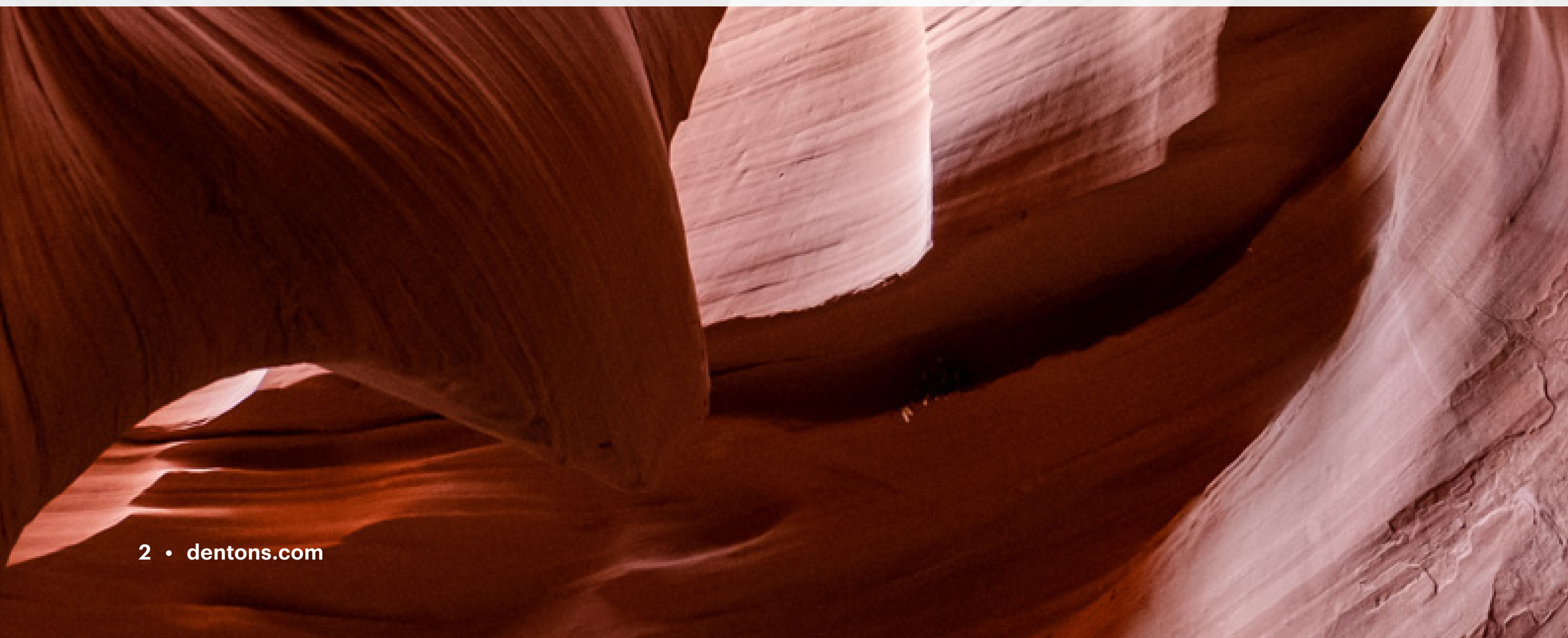
However, there are disadvantages to using RFRs instead of LIBOR in loan markets. These include:

a. Different RFRs measure different types of overnight borrowing, have different calculation methodologies and are published at different times, in each case in the principal financial centre of the currency for which they have been developed;

b. RFRs by nature have only a single tenor-overnight. "Raw" RFRs are therefore not well suited to fixing a rate of interest in advance over a typical interest period. It is worth noting that the global market has devised forward-looking RFRs such as CME Group Term SOFR Reference Rates;

c. IBOR's value is determined by elements such as the bank's credit risk that comprises the panel, liquidity risk, and other factors unique for that market, unlike RFRs.

Interestingly, some financial institutions in the Nigerian financial market have suggested a fixed interest rate or their cost of funds as alternatives to LIBOR.



Contractual Challenges and Possible Mitigants

a. **Absence of Calculation Fall back Provisions**: It is noteworthy that the transition poses thorny legal challenges as most contracts may not contemplate fall back provisions that cover the discontinuation of LIBOR and may end without a reference rate, thereby rendering them unviable. We note that recent agreements typically provide for rate replacement mechanics which either states how LIBOR may be replaced automatically or grant powers to the lender(s)/facility agent to select a replacement rate. Where contracts do not provide for fall back provisions, it becomes less likely to calculate the applicable interest rate payment upon cessation of LIBOR. This may lead to disagreements and legal disputes among parties.

   On a related note, for United States Law governed loans, it is noteworthy that recently, on March 15, 2022, President Biden signed the US$1.5 trillion omnibus spending bill into law. The bill included the Federal LIBOR legislation aimed at addressing contracts without (effective) fall back provisions.

b. **Review and Amendments to Finance Documents**: For facilities subject to LIBOR, it will become imperative to amend the loan terms so that the interest is calculated by reference to an RFR-based rate. Parties will have to assess and renegotiate existing facilities in order to incorporate agreed RFRs. It is also key for parties to pay attention to the choice of governing law. For Nigerian users of LIBOR financial instruments in cross border transactions, the choice of governing law is typically English law. The aim of a governing law clause is to make clear which country's substantive law will be applied to identify and interpret the rights and obligations of the parties to a contract. A governing law clause applies to a wide range of contractual issues. It governs not only interpretation and performance, but also the consequences of breach, including the assessment of damages and limitation. In this regard, it will therefore be useful to pay attention to regulatory changes proposed by the United Kingdom's Financial Conduct Authority (**"FCA"**).

c. **Consent Requirements**: Multiple consent to changes to the underlying finance document to reflect the new applicable RFR may be required from contractual parties, particularly where the borrower has different facilities.

d. **Potential Impact on Guarantees**: where there is a guarantee, the consent of the guarantor may also be required for the amendment of the finance document. In this instance, it will be prudent for the lender(s) to ensure that the guarantee provided by the guarantor is subsisting and remains binding.

Conclusion

For legacy transactions where applicable loan documentation do not specify a replacement for LIBOR or contain an adequate LIBOR replacement mechanism, costly disputes may arise as they rely on a rate which will cease to be published after December 31, 2023. It is therefore key for parties to identify all LIBOR exposures, and proactively work to amend existing documentation in order to ensure a neutral financial impact for all the parties. Dentons ACAS-Law continues to provide legal advisory services to its clients as they transition from LIBOR to RFRs.

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