HERBERT SMITH FREEHILLS

TREASURY EXCELLENCE AS STANDARD

CORPORATE DEBT AND TREASURY REPORT

ISSUE 7

MAY 2021

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Executive summary

- In contrast to the unprecedented impact that COVID-19 has had on our lives, the treasury outlook is positive having been the busiest year that many treasury professionals can remember. The preparation and contingency planning undertaken by corporate treasury teams in recent years placed many on a strong footing entering into the pandemic.
- Brexit-planning meant that, for the significant majority, Brexit itself was a non-event.
- The pandemic was a test of bank capitalisation plans and the banks withstood the shocks of the pandemic well; a number feared banks would not be sufficiently robust to deal with another crisis, but that was not borne out.
- ESG and sustainability is the key corporate treasury trend that has developed a self-perpetuating momentum.
- The day to deal with LIBOR transition has finally arrived; few are prepared, even fewer have transitioned and no one has welcomed it.
- The evolution of the role of treasurer has accelerated during, and as a result of, the pandemic, encompassing a plethora of responsibilities.
- For most there is access to significant pools of debt capital with few impediments to the raising of debt.

About our research and report

This research comprises a survey of, and follow-up interviews with, finance and treasury professionals of 100 large UK corporates (primarily FTSE 100, FTSE 250 and equivalents) conducted in January to March 2021.

We hope you find these findings informative and would like to thank those who participated in our research. In particular, we are grateful to those who took part in our follow-up interviews to discuss the survey results. Their views added depth to the research findings and their input has been invaluable. Thank you.

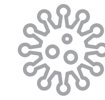
If you have any feedback on the research or its results, we would be very happy to receive it. We would also be delighted to hear from you if you are happy to take part in our research next year as we aim to make this report as useful to the treasury community as possible.

Some of the themes explored in this report are necessarily only addressed in headline terms. Over the course of the rest of the year, we will issue short form, practical insights on some of these issues and share views from other treasury professionals. If you would like to receive those please email laura.darke@hsf.com.

CORPORATE DEBT AND TREASURY REPORT
HERBERT SMITH FREEHILLS

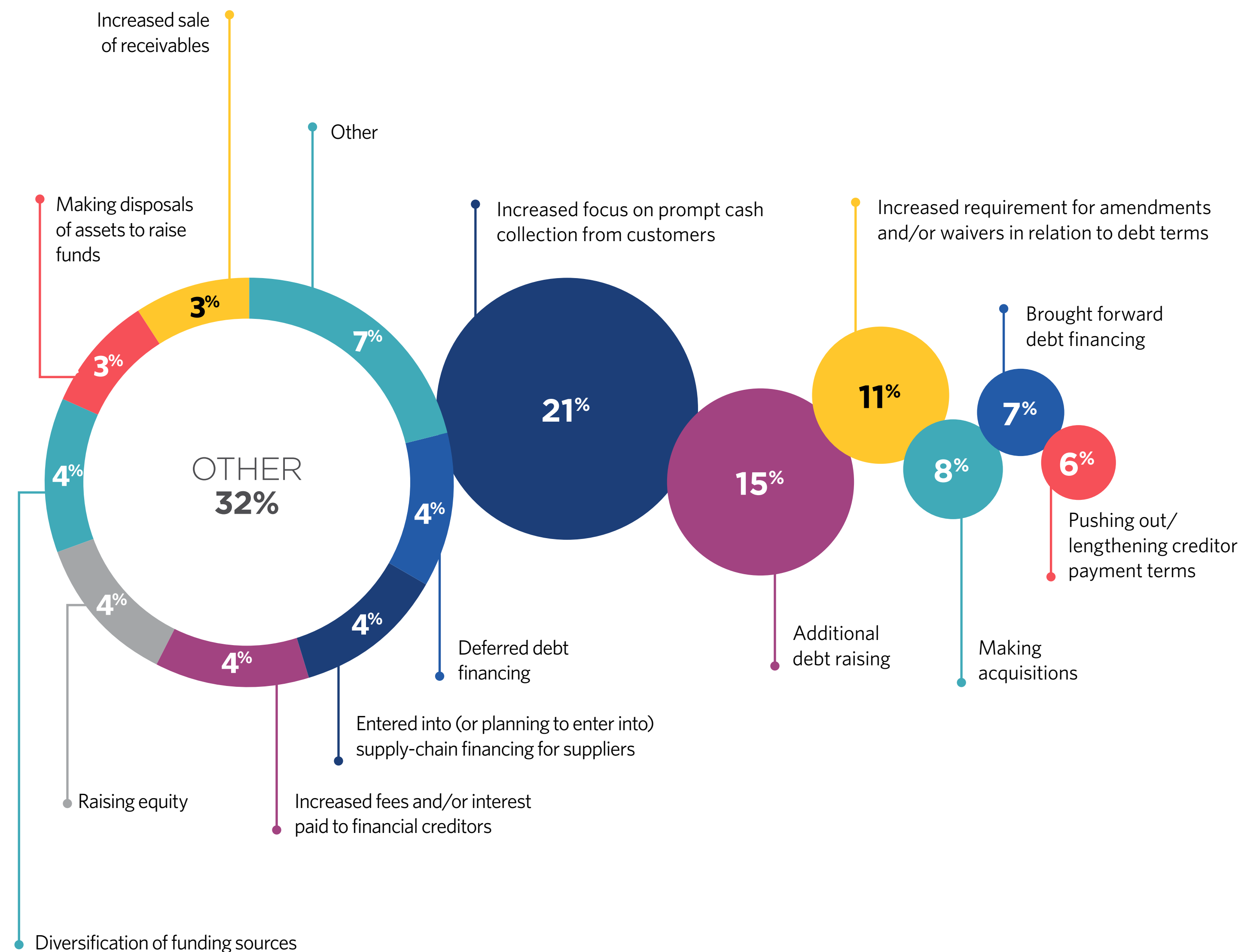
01
COVID-19

1 COVID-19



IMPACT

What impact has COVID-19 had on your treasury activities?



Analysis

- Unsurprisingly, the key focus was on cash collection and proactive cash management but there was a general sense that treasury teams were well prepared to tackle a crisis and that, in many ways, this level of preparation was something learned from the 2008-2009 financial crisis and the economic fallout thereafter.
- Lower numbers noted that they had raised debt and/or sought waivers in response to the pandemic than we were anticipating and which did not accord with the experiences of some respondents. This was, however, much more a feature of Spring-Summer 2020 and, for many, those contingency plans were seen as discrete 2020 workstreams which are now in run-off (eg 12-18 month waivers put in place or extended during 2020) whereas other respondents pointed to the fact that corporates customarily held significant headroom in their RCFs to cater for such events and that the pandemic had demonstrated the prudence in having significant committed facility headroom. Many had also preserved cash by deferring bond liability management exercises.
- A number reported that covenant waivers ended up not being needed and that incremental liquidity lines were later cancelled without being used.
- For many, there were initial concerns around the impact on bank liquidity which resulted in significant drawdowns under RCFs (sometimes re-deposited with those same lenders). Ultimately those concerns were unfounded and those positions were reversed over the course of 2020/early 2021.
- Some noted lower levels of equity raising than might have first been expected. This was explained partially as investors encouraged a 'wait-and-see' policy other than for those most acutely affected sectors.
- Clearly though, the position was more polarised along sectoral lines. The less severe consequences of the pandemic felt in certain sectors were wholly out of step with the unprecedented liquidity squeeze felt by others.

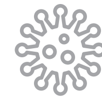
"Debt pricing went to hell"

"Banks were run off their feet...RMs were buried by the number of conversations"

"There was a degree of hunkering down if you were well capitalised"

"The experience of 2008 sharpened up companies' resilience and crisis management capabilities"

1 COVID-19



FINANCIAL SUPPORT SCHEMES

Did your business access any Government COVID-19 Finance Support Schemes in 2020?

70% NO

30% YES

Analysis

- Despite very attractive pricing (CCFF) or potentially being the primary or only route to incremental bank liquidity (CLBILS) there was only very selective utilisation of Government debt funding schemes by respondents. Particularly for the CCFF, a large number of corporates put the documentation and issuance processes in place as a contingency and that contingency was ultimately not required. There were general (and often unsubstantiated) concerns at the onset of the pandemic that banks might drawstop facilities and applications to the CCFF were seen as a natural risk response and a hedge to that.
- A number noted the dichotomy between the Government funding approach in 2020 compared to the approach in the 2008-2009 financial crisis and the subsequent recession. Many commended the Government for swiftly putting in place such expansive funding schemes.
- For some, the reticence to participate in these schemes arose from concerns around reputational risk (ie in accessing the schemes there was an admission of *'not having one's house in order'*). This was exacerbated when lists of those utilising the CCFF were published and the subsequent constraints relating to executive pay and dividends were a tipping point for many: this "sent Boards running for the hills" noted one respondent. In that way there was a perception that the schemes were positioned well, in that they were only taken up by those in genuine need (and whose businesses were disproportionately impacted by the pandemic) and without access to sufficient other borrowing options.
- There was also a perception that, together, the bank and DCM markets provided sufficient liquidity for many such that it wasn't necessary to utilise Government lending schemes.

"The unwritten element made us pause and as the terms evolved they became less attractive"

"Amazingly successful in the circumstances"

"This *[the CCFF]* would have been an additional buffer, why wouldn't you put it in place?"

"The Government response was very open and *[they]* realised that short term liquidity issues would kill businesses so opened the taps quickly"

FINANCIAL SUPPORT SCHEMES

Which schemes did you access?

60% CCFF

23% CLBILS

OTHER 17%

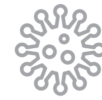
Analysis

- A reminder of the principal terms relating to CCFF and CLBILS can be found here.
- Perhaps representing the typical profile of respondents, the overwhelming majority of those who accessed Government schemes accessed the CCFF. In addition, the timeline and process to access the CCFF was seen as far smoother than the bank-led CLBILS option (with some noting that certain banks found the conditions to accessing the Government guarantee sometimes challenging depending upon the borrower in question).
- Of the 30% of respondents which had made arrangements to access Government funding schemes, 57% of those respondents had actually accessed the schemes (circa 15% of all respondents). For a number of respondents either the need for the additional liquidity buffer had passed or businesses had not been as badly impacted as forecasted and therefore initial drawings/issuance had been repaid and not re-drawn/issued.
- There are clear divergences of approach along sectoral lines.

"We applied for the CCFF but within a month decided to get out of it"

"Why withdraw? It became clear that there would be an element of 'naming-and-shaming'"

1 COVID-19



LESSONS LEARNED

From a treasury perspective, what were the most valuable/effective steps you took in response to the COVID-19 pandemic?

Analysis

- Forecasting, Liquidity and Cash Management became the treasury mantra.
- The feedback was overwhelmingly positive; treasury teams had contingency plans (primarily around cash management, reporting and spotting payment trends but also in relation to remote working and accessing treasury dealing platforms) and headroom to guide their businesses through the early days of the pandemic and provide stability.
- Liquidity management (both debt and cash) and frequent forecasting were by far the most reported workstreams.
- Many reported drawing down on existing liquidity lines until the impact of the pandemic on their businesses was better understood. A number of others actively increased liquidity through incremental liquidity RCFs, or through term loan lending in the bank and DCM markets and equity raisings (often undertaken by way of placings completed on very short timetables). Many reported proactive engagement with their lenders, in particular banks (as the primary source of quick liquidity) as a key workstream.
- The year was typified by the deferral of refinancings in favour of one year 'amend and extend' exercises which are now feeding through in the market as well as moving the window to exercise extension options.

"Keep calm and keep doing the basics"

"Normal treasury activity at a higher cadence"

"The experience of 2008 sharpened our focus on risk and risk reporting"

"Reacted quickly and over-funded first, corrected later"

"We didn't actually require access to the funds, but the liquidity reassurance was worth the premium paid"

"Becoming more data driven and focussed on understanding short-medium term cash drivers"

THE EXPANDING ROLE OF TREASURY

The role of treasury continues to evolve and expand in many businesses. If this applies to your business, what areas does this apply to?

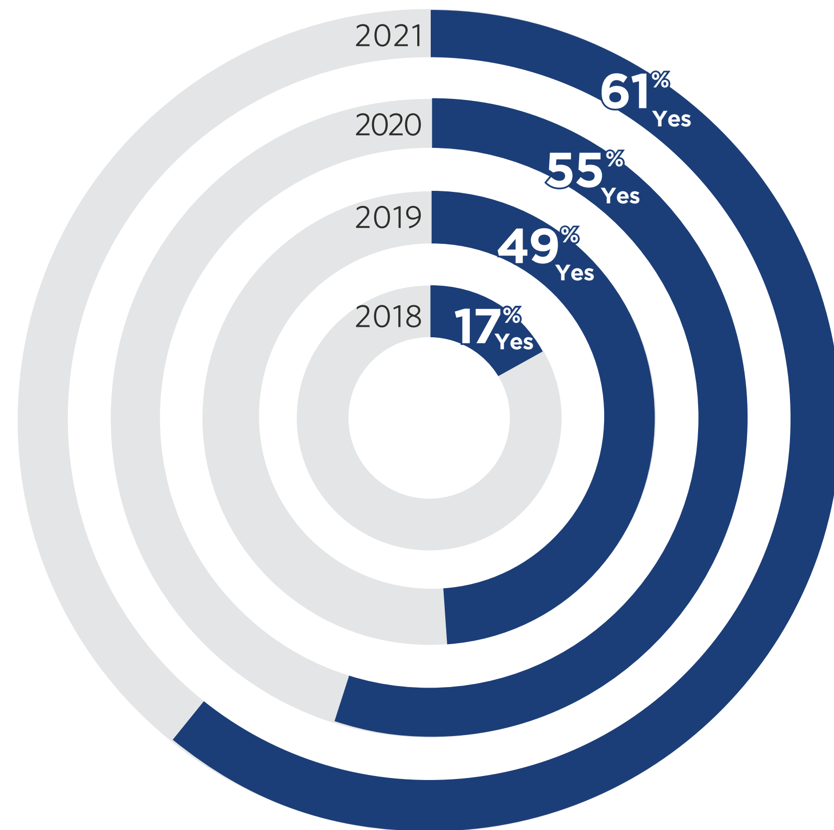
CORPORATE DEBT AND TREASURY REPORT HERBERT SMITH FREEHILLS

02 ESG & SUSTAINABLE FINANCE

2 ESG & SUSTAINABLE FINANCE

DEBT FUNDING

Is ESG a factor for you when formulating your debt funding strategy?



"Banks are saying: "Put your money where your mouth is""

"The benefit is really investor relations, not pricing"

"It's a reputational issue to ignore ESG now"

Analysis

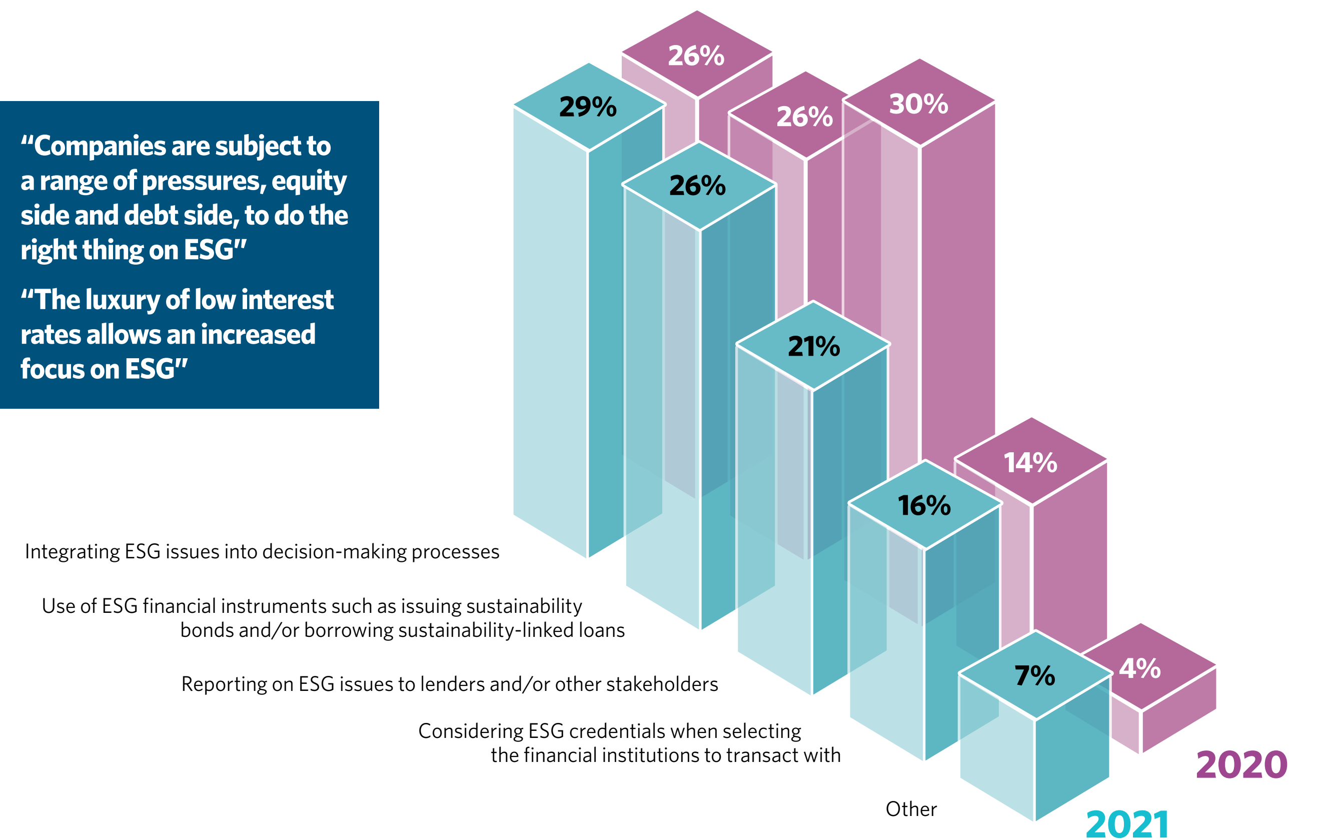
- Whilst partially suppressed during the early onset of the pandemic, the focus on ESG and sustainability-linked finance has raced back to the top of the corporate treasury agenda. A number of respondents suggested that this was becoming BAU (for example, as ESG reporting is contained within plc audited financial statements rather than being bespoke).
- ESG is the key talking point for most in corporate treasury and is seen as a welcome distraction from LIBOR transition.
- Some respondents felt that that was still a lot more discussion than implementation and that certainly the European markets were leading the way with much less focus in the US markets to date.
- Many felt that whilst there were reputational issues in committing to ESG/sustainability targets there was a broader anti-embarrassment issue if a corporate failed to incorporate an element of ESG/sustainable financings in their debt capital structure given the strong growth of this trend. The focus is very much on aligning with the corporate ESG agenda which is investor and customer driven rather than economically driven (as one respondent noted, the additional upfront work and monitoring certainly outweighed the net 0.01% commitment fee saving they would benefit from under their undrawn liquidity facility).
- Some respondents felt that the flat survey responses compared to 2020 did not accurately reflect the resurgence of ESG in recent months and pointed towards this becoming more BAU activity.

DEBT FUNDING

Please indicate how you are applying these factors.

"Companies are subject to a range of pressures, equity side and debt side, to do the right thing on ESG"

"The luxury of low interest rates allows an increased focus on ESG"



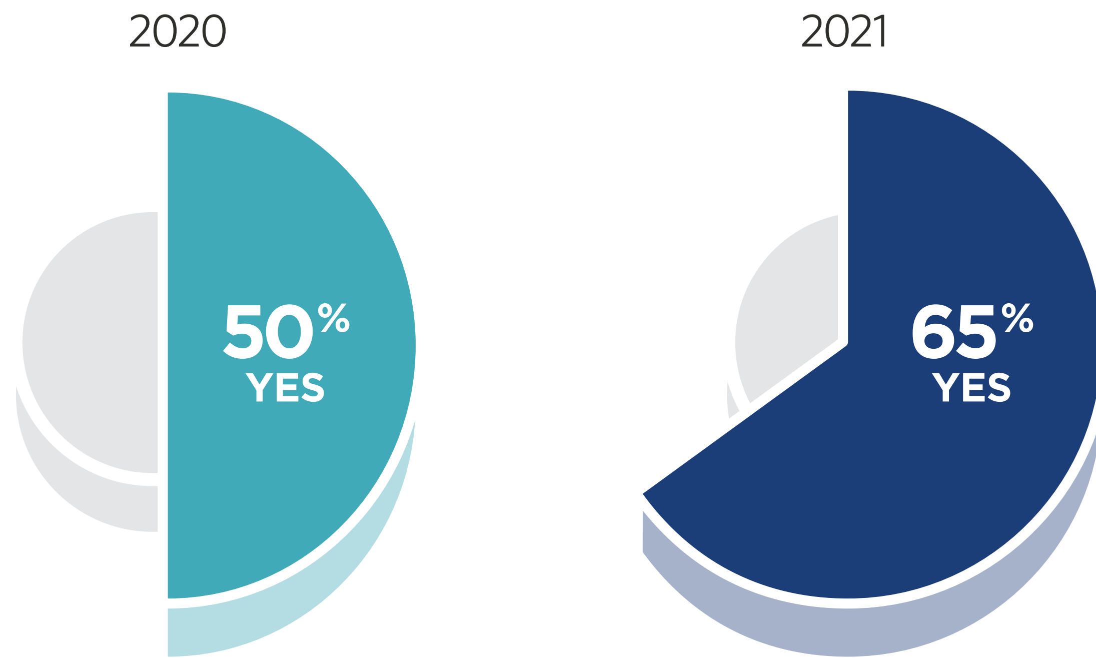
Analysis

- A number of respondents noted that it was too soon on their ESG journey to actually incorporate ESG elements within their debt financings (and there is little evidence of corporates amending existing financings solely to introduce sustainability-linked elements though we are aware that some are considering it). As such, implementation of sustainability-linked features within corporate financings will likely remain tied to refinancing timelines for now.
- The proportion of respondents implementing ESG/sustainability financings this year remains static at 29% but, as reported on the next page, two thirds of respondents plan to include ESG features in their next refinancing (perhaps suggesting that whilst ESG is firmly on the agenda its implementation may be a medium term prospect). In our recent experience the majority of corporate RCF refinancings have included sustainability-linked pricing adjustments and a number of our corporate DCM issuers have implemented an ESG framework and issued sustainability bonds over the course of 2020. There was also a sense from some respondents that there has been a surge in ESG focus since February.
- Some respondents noted that the fall in reporting on ESG issues may be explained by their inclusion in the financial statements which obviated the need for specific additional reporting outside of green financings.

2 ESG & SUSTAINABLE FINANCE

NEXT FINANCING

Do you plan to include ESG features in your next financing and what are the key drivers for this?



Analysis

- The percentage of those planning to include ESG in their next financing broadly reflects our experience.
- The key drivers are not pricing (reported by only 14% of respondents) or a concern that this is necessary to access particular pools of capital (13%), it is being driven by the Board and its corporate strategy (27% of respondents) as well as being driven by the emphasis placed on ESG by customers, investors and other stakeholders (38% of respondents).
- For sustainability-linked loans, a 2.5 basis point margin reduction is not sufficient to drive the ESG agenda itself, particularly for undrawn RCFs where the saving in commitment fees is 35%-40% of that. It was certainly felt that the pricing savings available were not sufficient to drive behavioural change in the loan markets. In the DCM markets where larger margin adjustments are expected in the context of sustainability-linked products (typically 25 basis points which can be split into up to two sustainability KPIs) this could become a significant driver.
- At this stage there was no suggestion that the absence of ESG features would preclude raising debt from existing sources of finance.

"You've got to think ahead on financings, you could get away without *[it]* now but how will that look in 3 years' time?"

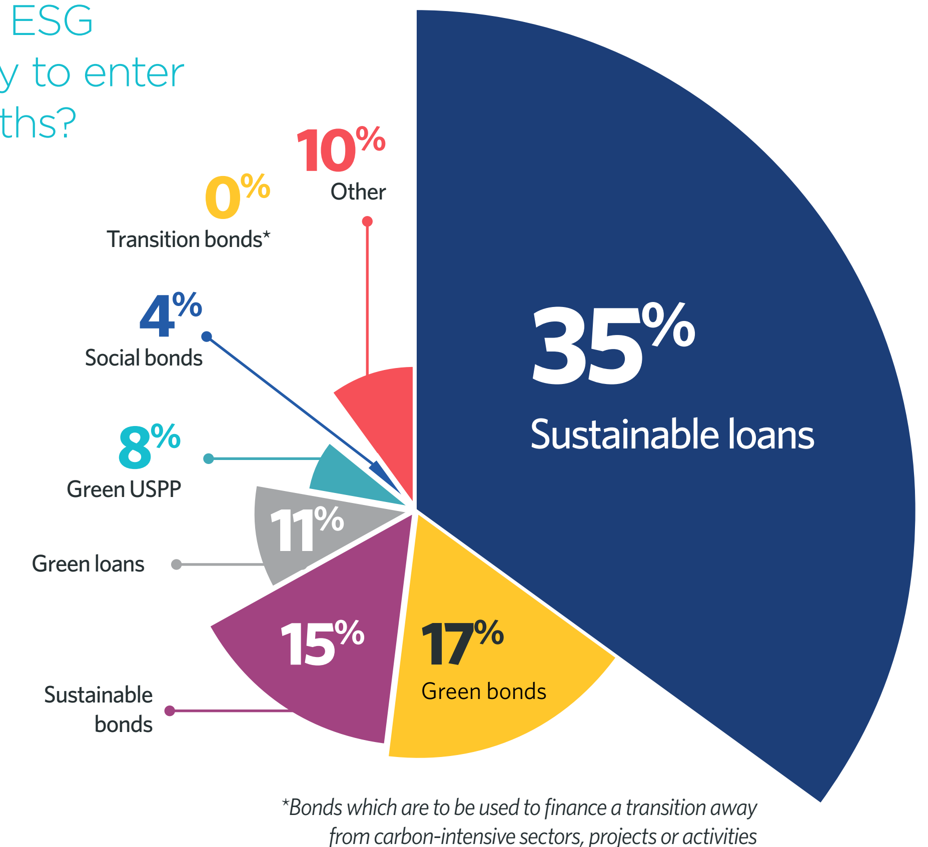
"The economic upside for meeting targets is far outweighed by the reputational downside for failing to meet them"

NEXT FINANCING

Which of the following ESG financings are you likely to enter into in the next 12 months?

"At some point in the future the question will be 'Why aren't you *[borrowing in this way]*?'"

"The question will be: Why aren't you putting sustainability features into your next financing?"



**Bonds which are to be used to finance a transition away from carbon-intensive sectors, projects or activities*

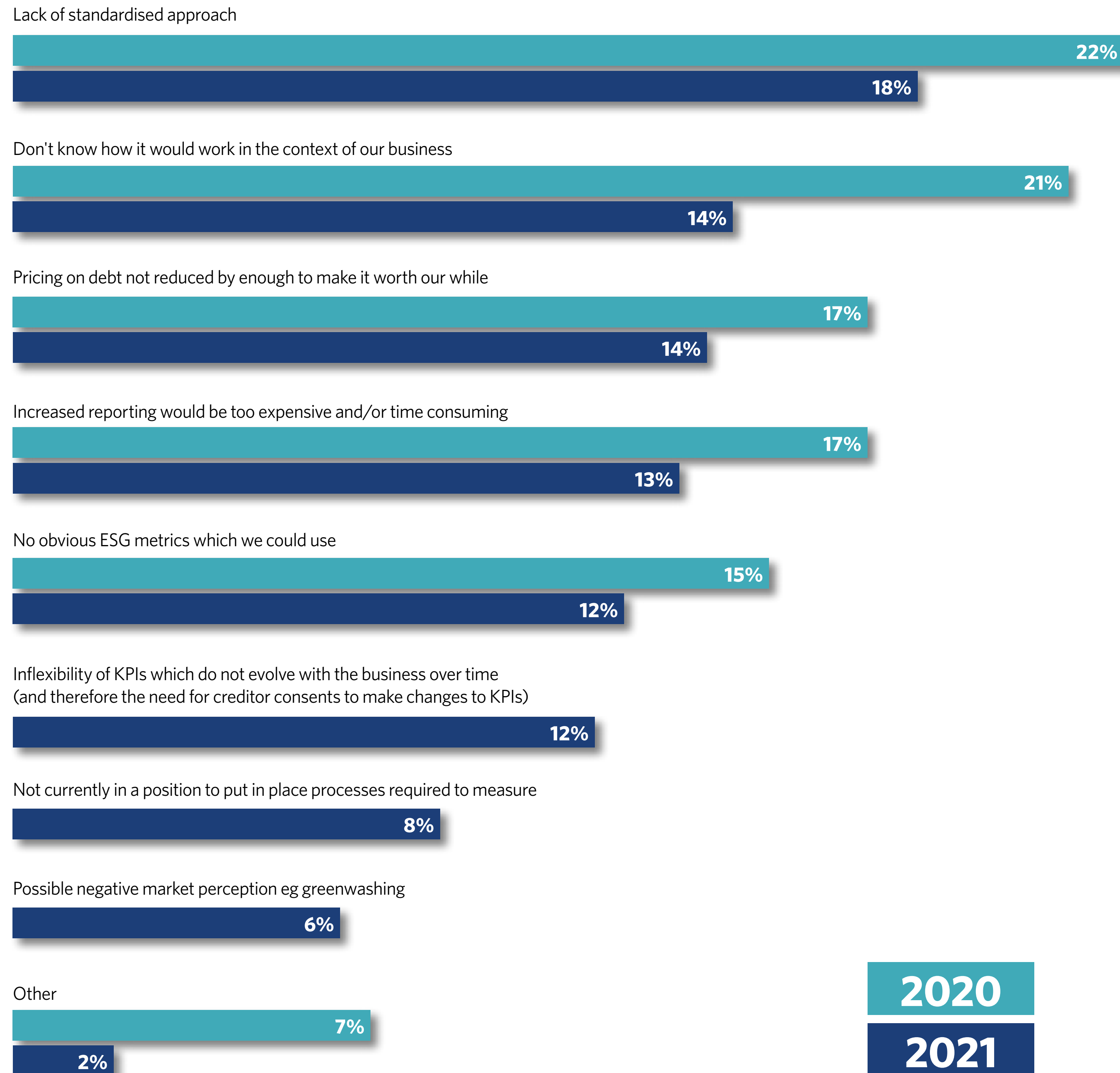
Analysis

- Comparatively lower numbers are pursuing green loans when compared to sustainability-linked loans. This is partially explained both in relation to the use of green loans as well as the ongoing reporting and other structural controls over funds which typically form part of green lending. For a brief overview of sustainability-linked loans see here.
- There is a sense that green loans and bonds could see much broader application in the future as corporates generally pursue specific aspects of their ESG targets via green-lending eg the transition of fleet to electric vehicles, the transition to self-generated renewable energy etc In this way green-lending would become a more mainstream corporate borrowing tool rather than being more particularly focussed on eg renewable energy companies.
- Sustainability-linked loans were the most reported ESG-debt financing reflecting both the considerable number of loans already made (and therefore the process and terms being well understood in the market) but also the ability of that product to apply across a multitude of different sectors with ESG KPIs tailored to that borrower. The light touch covenant reporting (typically via the audited financial statements and a KPI reporting certificate) also mean that it is attractive from an ongoing reporting perspective. For US bonds, certifications range from issuer self-certification to adding external verifiers for compliance to KPIs.
- The focus on green bonds and sustainable bonds is in line with our experience across the bond markets with many issuers now including an ESG framework to their EMTN programmes and opening up the option to issue bonds under the ESG umbrella.
- There has been a significant amount of publicity in relation to transition bonds but to date their utilisation has been limited given their focus.

2 ESG & SUSTAINABLE FINANCE

IMPEDIMENTS

What do you consider to be the principal impediments to corporates incorporating ESG elements into their financings?



Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

Analysis

- In comparison to 2020 the impediments to incorporating ESG elements into financings are weakening, as should be the case as the markets continue to develop and refine ESG financings and they become better understood.
- The responses also illustrate the diversity of the impediments, some of which will be more acute than others depending upon how developed a corporate's broader ESG strategy is (treasury cannot be expected to operate in a vacuum!).
- The focus of ESG at a board level is likely to drive down a number of these impediments over time and, as noted above, the cost-benefit impediment is likely to be outweighed over time by the desire to align with corporate strategy.
- The lack of standardisation has not held back certain products (such as sustainability-linked loans) and standardisation seems to be some way off given the number of interested parties publishing ESG criteria and the continued evolution of those regimes themselves.
- There is a concern around the reliance on published unsolicited ESG ratings, particularly the risk of downgrades arising from unilateral changes to the ratings methodologies employed.
- The 'E' is much better understood and most easily capable of being objectively measurable. There are concerns that 'S' and 'G' can be softer targets which could be the focus of allegations of what would be described in an environmental context as 'green-washing' and therefore often a particular focus for lenders.
- There was a majority view that the pandemic had not increased the importance of ESG in financings. It had certainly fuelled the debate (in the context of the economic recovery from the pandemic) about the roles and purpose of companies in broader society but that had not translated specifically to pushing ESG up the treasury agenda.

"It's more about making it up as we go along....the market is new and fragmented....there is a feeling of unknown unknowns"

"Pricing is neither here nor there – it's going to become standard market practice and a business imperative"

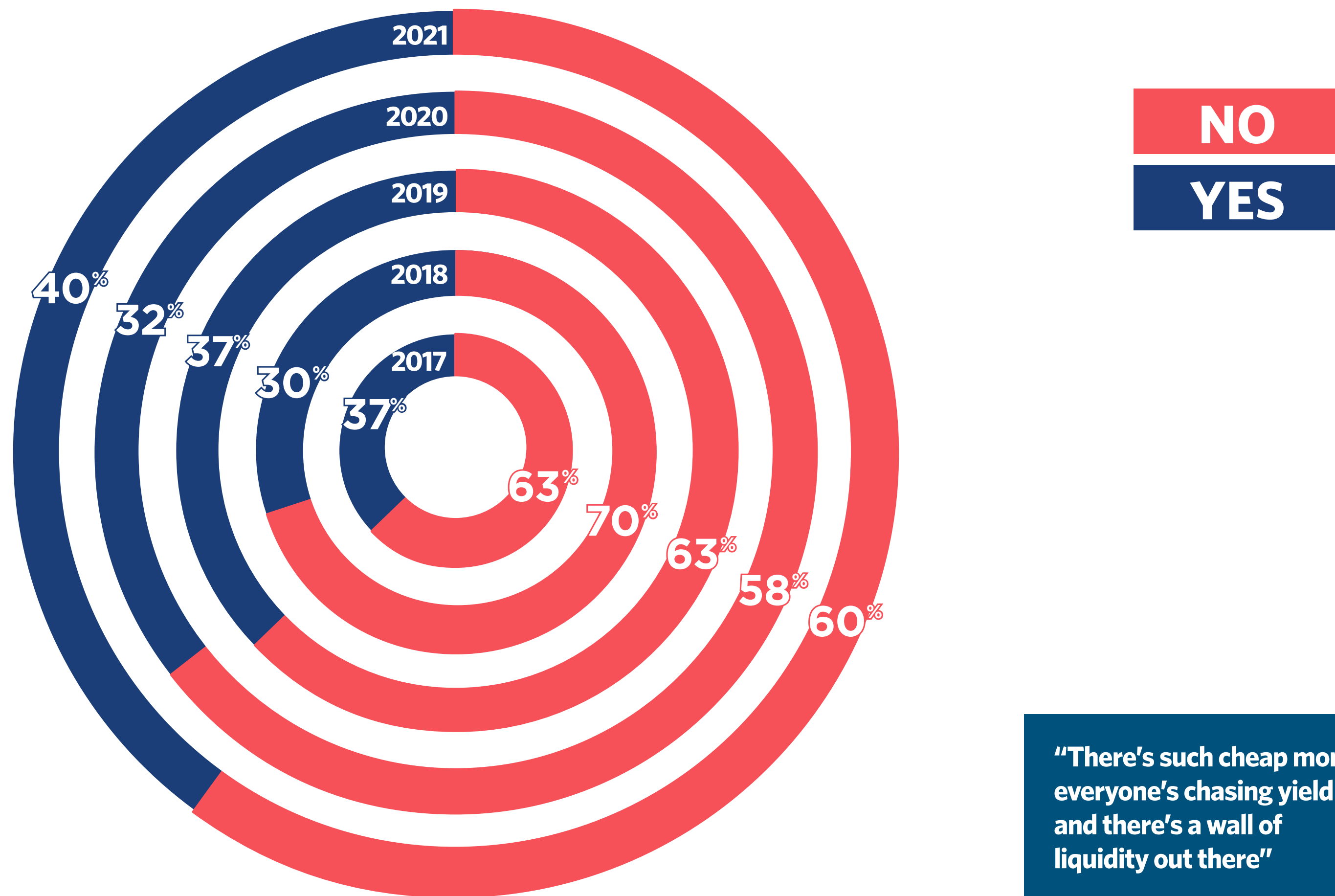
Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

03 DEBT FINANCING

3 DEBT FINANCING

INCREASE IN NET DEBT

Do you plan to increase your net debt this year (other than as part of usual seasonal adjustments)?



NO
YES

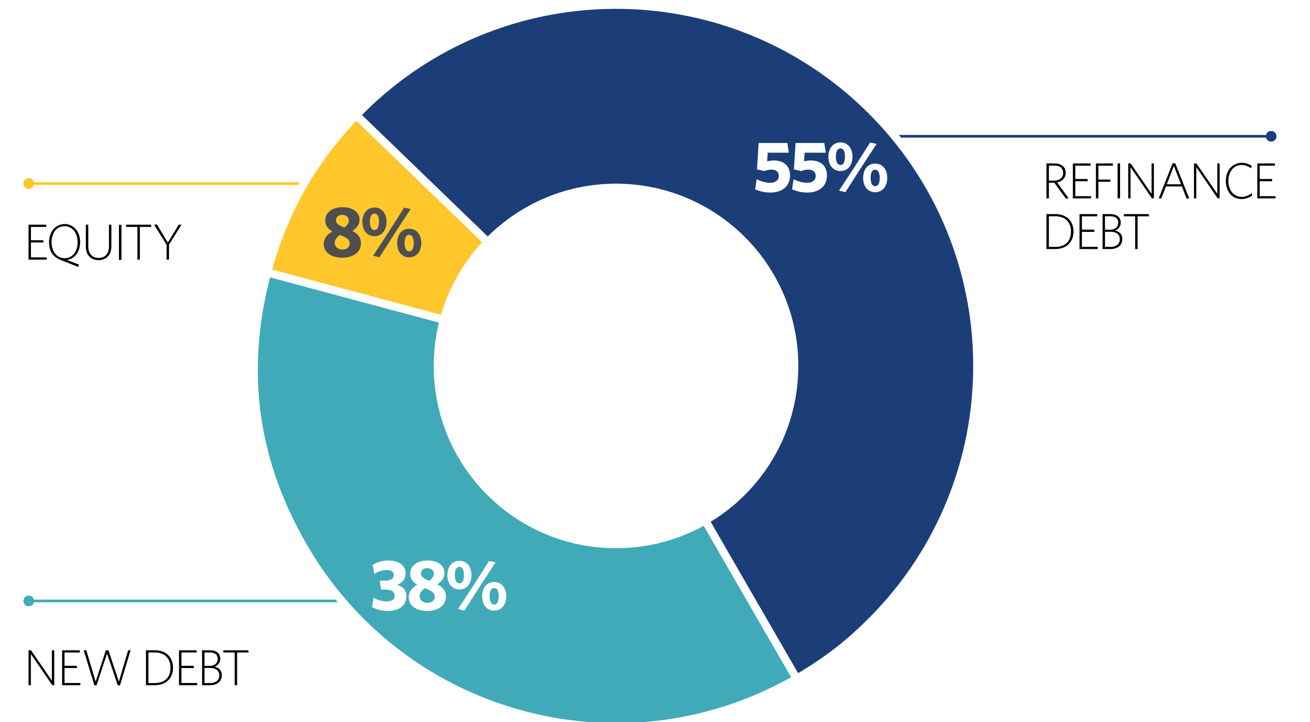
"There's such cheap money, everyone's chasing yield and there's a wall of liquidity out there"

Analysis

- The 2020 data was obtained in the month before the March lockdown when few, if any, had foreseen the potential impact of the pandemic and the 2020 data was certainly not representative of the remainder of that year.
- Many respondents noted that higher levels of debt raising would have been seen throughout 2020 and that much of the pandemic-related debt had already been raised. This may have been the reason why a higher number was not projected for 2021 than might otherwise have been expected. Only a third of respondents reported that higher debt raising in 2021 was as a result of the pandemic.
- Others noted that there had been a degree of unwinding some of the liquidity preservation measures that had been put in place in 2020 and that many businesses had introduced cost cutting measures (such as scaling back/later phasing capital expenditure) which had reduced the need for additional debt. Some noted that such cost cutting measures were starting to be reversed and further investment meant that further debt raising would be required.
- With a bounce-back from the pandemic predicted, some expressed concerns that the deep pool of liquidity represented the risk of a debt bubble forming.

FINANCING

Do you plan to raise new capital this year?



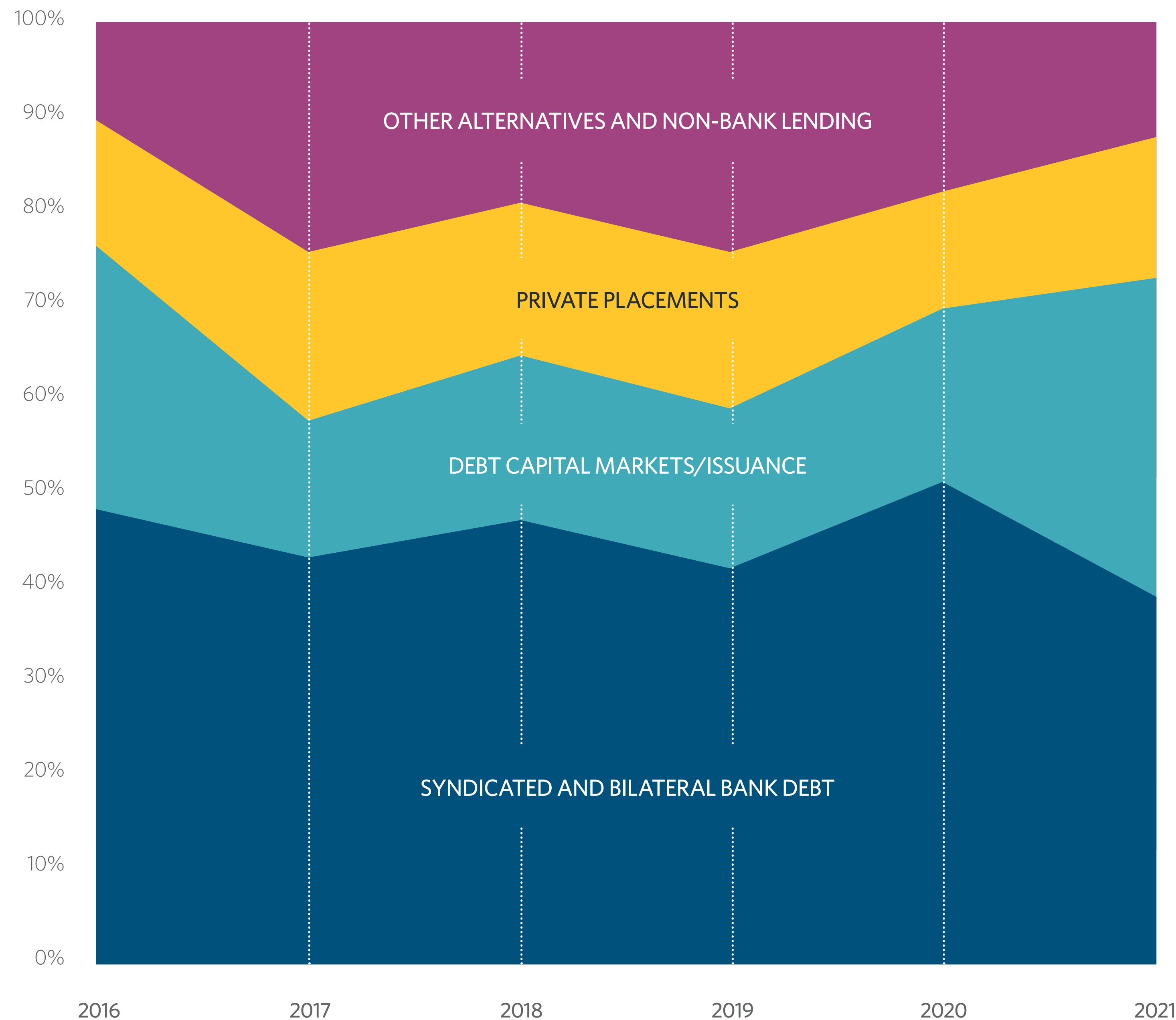
Analysis

- This year we see those who had last year temporarily extended their bank financings via one year 'amend and extends' now formally refinancing their facilities (although few are able to roll-over their existing 5+1+1 RCFs, the hard long-stop of a 3 year facility seen last year has now receded with many able to secure 3+1+1 RCF and term loans as a minimum).
- Some noted that 8% of corporates planning to raise equity was high (raising of equity generally being event driven and therefore suggesting that there may be an acknowledgement by some that their debt levels are too high).
- There is little evidence of corporates bringing forward refinancings simply to address LIBOR transition.
- The USPP market and US capital markets remain extremely active with both new issuance as well as refinancings. Some corporates are taking advantage of the demand from investors in order to issue debt ahead of maturity walls.
- The European debt capital markets are extremely active with new issues and refinancings, with issuers taking advantage of favourable pricing terms, investor appetite and quick issuance windows.

3 DEBT FINANCING

SOURCES OF ADDITIONAL DEBT

If you plan to raise new debt or refinance existing debt in 2021, how will this be achieved?



Analysis

- Many noted the significant shift to the DCM markets in 2021 and a number of different reasons were cited for this (including the resilience, depth and pricing in those markets as well as the refinancing of 2016 issuance (which was another significant year for DCM for our respondents)).
- There were mixed responses from respondents on the approaches of their lending banks during the pandemic. Some noted that banks were supportive in providing contingency liquidity facilities at short notice, whereas others reported that bank responses to requests for further debt ultimately pushed them towards the DCM markets.
- Those respondents raising debt in the PP markets appears static year on year. One respondent noted that there was a risk that this could become "yesterday's market" given the lack of flexibility in tailoring the type and term of the financing in the same way as could be found in the bank markets and the much more significant covenant expectations compared to the DCM markets (for those able to access them). The lengthy process of waivers and amendments have dampened some corporates' appetite for the USPP market. In particular, the downgrades of one or more ratings of some corporates during the pandemic have triggered a step up in coupons in their USPPs and moved them away from the typical credit profiles that PP investors are interested in. Therefore, we are seeing the temporary "fallen angels" accessing the US capital markets in the form of yankee bonds with cov-lite covenants. Some flagged that, as corporates grew, they would transition from the PP to DCM markets whilst others issued debt in both markets and arbitraged interest rate opportunities.
- In relation to the alternative/non-bank lending, some respondents referred to supply chain financings and how they had fallen out of favour in the light of some recent corporate insolvencies although a number also pointed to the fact that their suppliers were not utilising the supply chain financing platforms that they had established despite it appearing to offer a cheaper cost of funding.
- Anecdotally we hear of banks being more selective in where they invest their capital and the ever increasing focus on returns has meant that, for some, the banks have no longer been the backstop providers of liquidity. As one respondent noted *"Why do companies use bank debt? Because it's easier, cheaper and quicker. When it's not they look elsewhere"*.
- The survey responses also show the ongoing importance of bilateral bank financings (as either the principal or top-up financing) which accounted for a quarter of all predicted future borrowing (no further CLBILS borrowing was expected).
- There is a clear dichotomy between experiences working with banks.

Corporates..."were pushed into the bond markets.....banks supporting long term relationships had failed, and that was nerve-wracking"

".....early conversations with lending groups. Substantially all were proactive in trying to find solutions......very different to 2008/2009"

The DCM market "is in rude health in 2021 relative to the bank market"

"USPPs clung to their covenants when most others had let go"

"Investors are looking for yield so even those in hard hit sectors are successfully accessing the bond markets"

"Banks don't like lending. It's a real schizophrenic market for syndicated and bilateral lending. Banks are more and more reticent to lend, especially when interest rates are so low. Banks are more picky about sectors too and becoming more binary with a focus on specific sectors. So bond markets have taken on more weight"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

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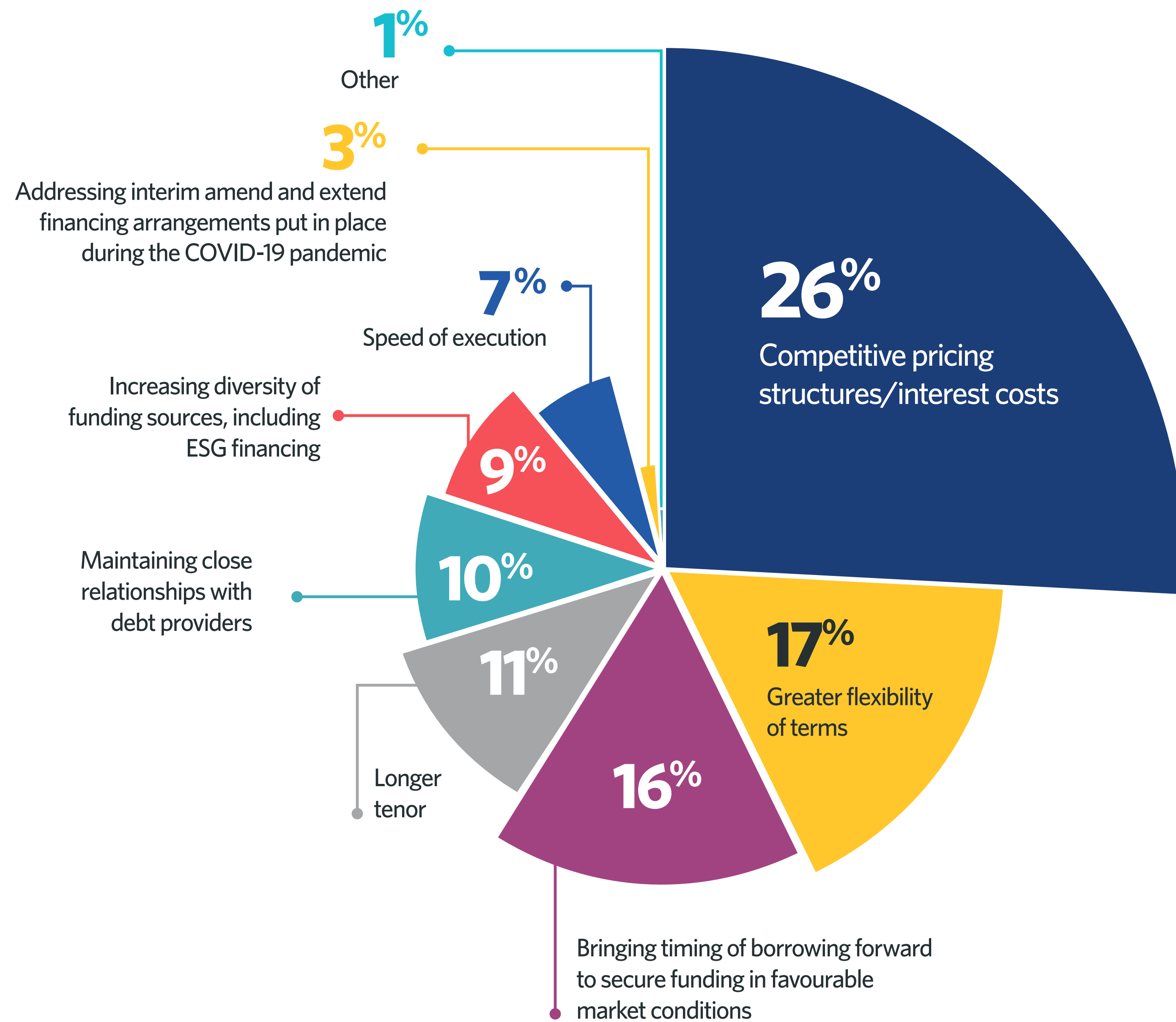
CORPORATE DEBT AND TREASURY REPORT HERBERT SMITH FREEHILLS

3 DEBT FINANCING

DRIVERS FOR BORROWING

If you are considering borrowing this year, what are your main drivers for choosing a particular source of funding?



Analysis

- Year on year (and despite the pandemic) the primary drivers are unchanged (though the responses may have been very different in Summer 2020).
- A number of respondents noted that this demonstrated that, even in challenging times, there was less need to lean on bank lending relationships to ensure sufficient liquidity. A number of respondents noted that banks seemed to be less relationship driven and therefore less reliable as a source of debt.
- There was a general perception that banks had pushed to make their lending terms more stringent in 2020 but that there was always a price for debt (ie there was no market wide impediment that couldn't be resolved by price).
- Even prior to the pandemic there was anecdotal evidence of banks being much more focussed on where they deployed their capital and therefore the movement in bank syndicate groups (incoming/exiting lenders) which we have seen seems likely to continue. Given the subsidised RCF-ancillary business model, treasury teams are under pressure to move ancillary business around changing syndicate members which can be a particular headache when it comes to cash management.
- As a counter-balance, the bank markets had continued to lend and commit capital throughout the pandemic, though transaction timetables had taken significantly longer and lenders tightened tenors generally.
- Some noted that some banks had a preference to have their facilities drawn, others not and this was a complicating factor in a syndicated refinancing process.
- For those that have EMTN programmes set up or already have bonds outstanding the bond markets are very simple to access and provide a welcome source of diversification at attractive pricing given current demand across the DCM and with quick issuance windows.
- The US capital and loan markets have always provided for depth of investors and therefore remain attractive for larger issuances where competitive demand from US investors provide for competitive pricings for corporates.

We are "beaten up continually about ancillary"

"Treasurers can get too hung-up on marginal price difference....and lose sight of the strategic goal"

"Banks are becoming more transactional so the relationship is less reliable for corporates than in the past"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

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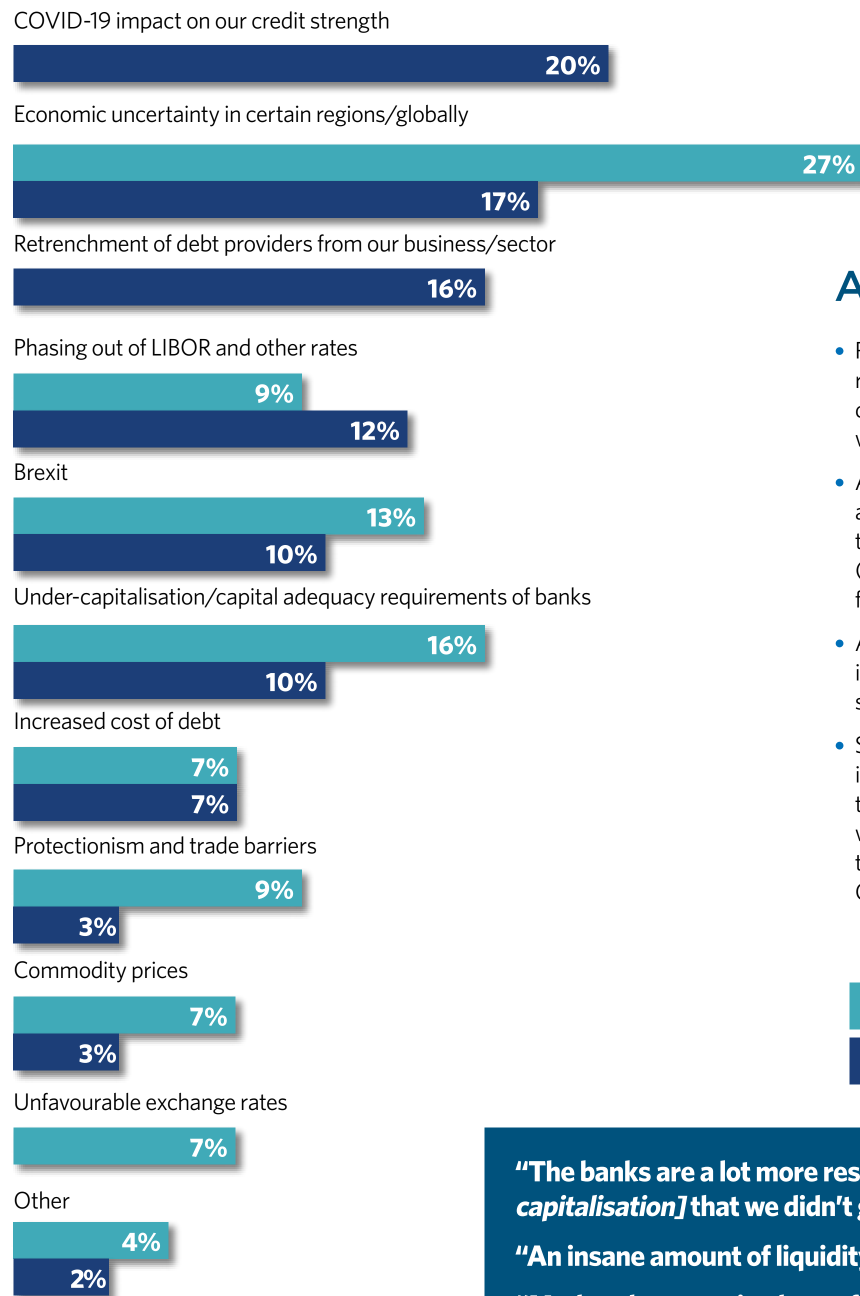
3 DEBT FINANCING

IMPEDIMENTS TO DEBT RAISING

What do you consider to be the major impediments to corporates raising debt in the year ahead?



Analysis

- Respondents noted far weaker impediments to raising debt than in early 2020 (the 2020 survey data undertaken prior to the March lockdown and was broadly consistent with 2019 data).
- A sense of optimism prevailed that most would be able to raise or access debt finance now given that they had been able to in the depths of the pandemic (and that banks had constructively responded to financial covenant waivers etc when needed).
- A sense that the large amounts of liquidity available in the markets had assuaged concerns of a debt squeeze.
- Some respondents pointed to the risk of rising inflation as a potential issue in the short/medium term and others were more cautious flagging that we had not seen the economic consequences of the pandemic, which had been staved off by Government support in its numerous guises.

2020
2021

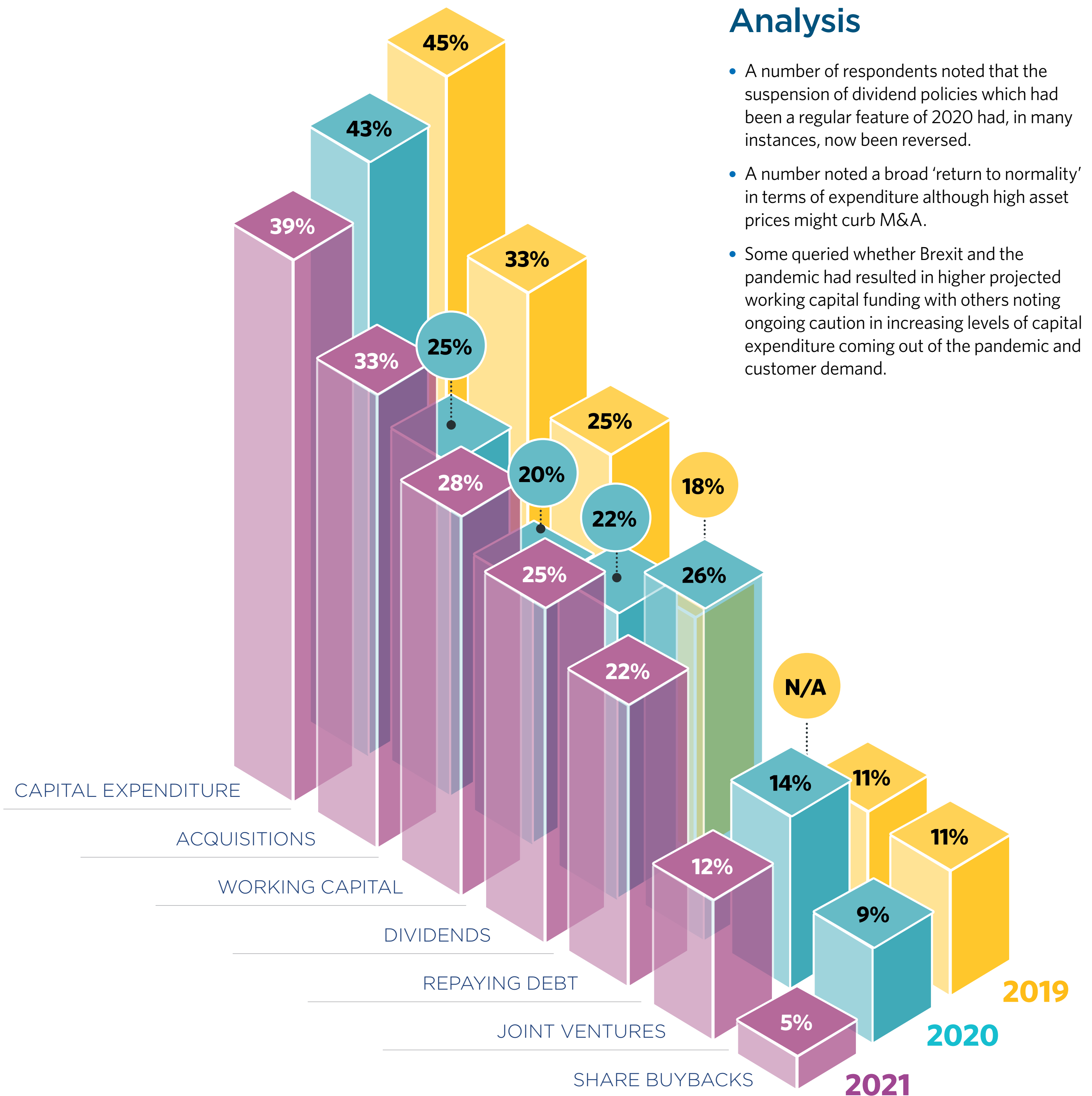
"The banks are a lot more resilient now and it's a testament *[to their capitalisation]* that we didn't go into a full financial melt-down"

"An insane amount of liquidity has been pumped into the system"

"Markets have survived one of the biggest disruptions ever and people can see the other end so people are seeing more reasons for optimism"

EXPENDITURE

Looking ahead, how do you anticipate that your expenditure on the following will compare to last year?



Analysis

- A number of respondents noted that the suspension of dividend policies which had been a regular feature of 2020 had, in many instances, now been reversed.
- A number noted a broad 'return to normality' in terms of expenditure although high asset prices might curb M&A.
- Some queried whether Brexit and the pandemic had resulted in higher projected working capital funding with others noting ongoing caution in increasing levels of capital expenditure coming out of the pandemic and customer demand.

3 DEBT FINANCING

CREDITOR BEHAVIOUR

Are you experiencing more cautious credit behaviours from your creditors (debt providers/suppliers etc)?

60% NO

40% YES

Analysis

- Most of those answering 'yes' in relation to creditors pointed towards their financial creditors (limiting or increasing the cost of uncommitted lines, increased financial reporting requests, tightening lending criteria).
- However, counter-balanced to that, where there was an immediate need to retain the availability of working capital facilities such as RCFs, lenders were forthcoming with financial covenant waiver requests which had been triggered by the pandemic.
- Some respondents noted that supply chain financing structures which they had put in place for their suppliers were not being significantly utilised despite evidence that they offered a lower cost of funding.

> **"Now was not a time to squeeze the supply chain"**
>
> **"Banks are conserving capital and so may be less amenable to rolling or extending facilities"**

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

CREDITOR BEHAVIOUR

Are you experiencing more cautious credit behaviours from your customers in the way that they transact with you?

81% NO

19% YES

- Very few reported more cautious customer behaviours with some pointing to the negative publicity associated with this, particularly for those who had made contrary commitments eg being a signatory to the Prompt Payment Code.

> **"There's a general sense of accountability for corporate behaviour"**
>
> **"Generally supply chains have been liquid, robust and transparent so problems have been isolated"**

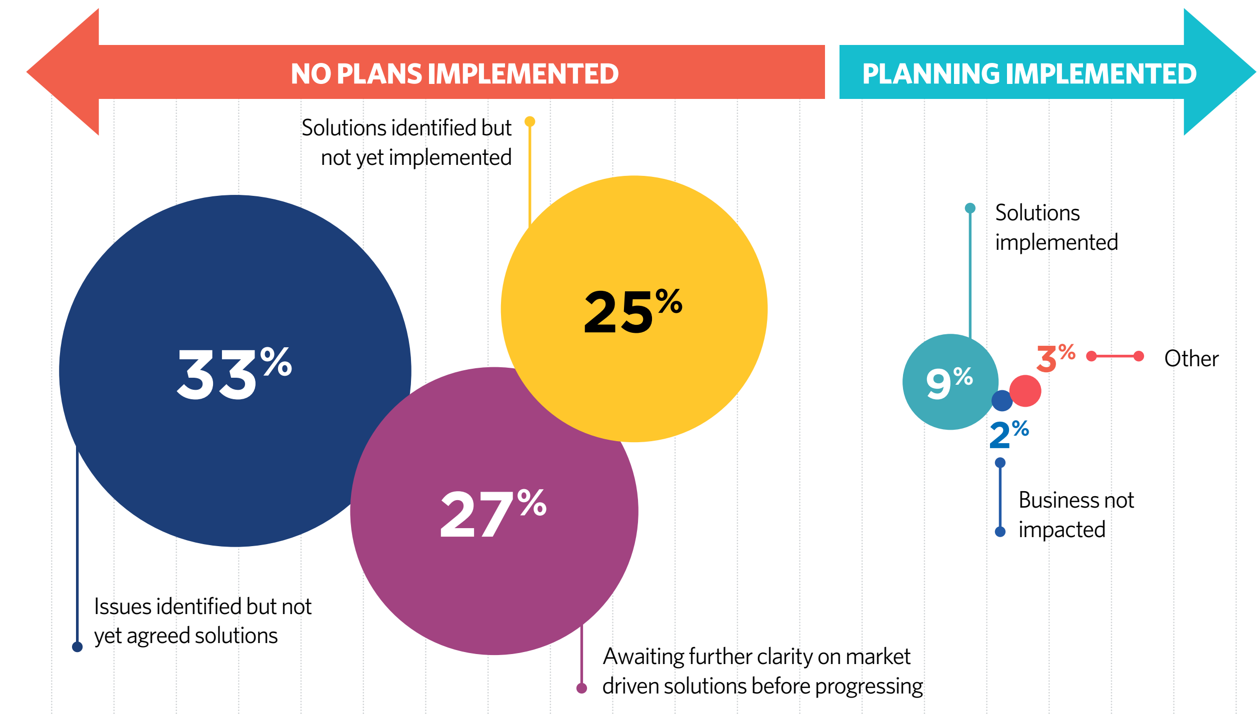
Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

04
IBOR/LIBOR

4 LIBOR

IBOR/LIBOR

At what stage is your planning for the transition from IBOR/LIBOR?



Analysis

- The cessation of LIBOR and other IBOR rates promises to be one of the major challenges facing corporates and the wider market over 2021 and beyond. As indicated by the responses to the survey, only a small number of corporates are not affected by LIBOR cessation (around 5%), with over 80% of respondents having grappled with the issues posed by LIBOR transition to varying degrees. Many respondents highlighted LIBOR transition as one of the main focus areas for treasurers over 2021, with board level attention and treasurers being required to consider the impact on business outside of the impact on financial products (including the use of LIBOR in non-financial contracts).
- That said, the responses to these questions demonstrate the wide spectrum of readiness among the corporate market for the end of LIBOR, and this response level is indicative of the state of uncertainty which surrounds this issue. Only 9% of respondents have implemented solutions, with some highlighting that "loan documentation [has been] amended but transition [will] not happen until later this year."
- A significant minority of 27% of respondents are in a 'wait-and-see' mode and await the further development of market led solutions. The remaining respondents are in between, having either identified issues or solutions, but having not yet fully implemented LIBOR transition plans.
- This state of readiness reflects our discussions with corporates, many of whom have an awareness of LIBOR transition, but view it is a technical change with a frustrating burden on stretched resources, or are reluctant to suffer the potential risks of being one of the first movers on the issue and are waiting for standardised conventions to develop and banks to set out formalised processes for LIBOR transition. Many expect to execute LIBOR transition during Q2/Q3 2021, or to tie it into other amendments or events relating to debt facilities (including refinancings or other amendments).
- The divergent approaches taken between the loans and derivatives markets stands out as one of the major headaches faced by corporates, with frustration clear that the market did not adopt a more standardised approach and this is one of the reasons corporates are hesitant to fully execute LIBOR transition plans.

> **The market is being "dragged by the fingernails towards a solution"**
>
> **"Not something that keeps me up at night"**

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

4 LIBOR

IBOR/LIBOR

Have you executed a risk free rate or alternative reference rate transaction in preparation for IBOR/LIBOR cessation?

84% NO

16% YES

Analysis

- Continuing the themes highlighted above, only a small number of corporates have executed a risk free rate transaction in anticipation of LIBOR cessation. This is in line with our experience, where corporates are increasingly engaging with the issues posed by LIBOR transition and taking preparation steps, but limited numbers of corporates have actively transitioned away from LIBOR.
- Noting that LIBOR in all currencies other than USD is due to cease by end 2021, interviewees noted that many corporates are “not as ready as they need to be”, with others noting that it seemed entirely possible “some deadlines will need to be extended”. This state of readiness on the corporate side of the market is entirely understandable given the delays in the phasing out of LIBOR, with standards and conventions still being set some few months before LIBOR is due to cease and many banks themselves still gearing up for the market-wide LIBOR transition challenges to come.
- Interesting examples of the types of RFR transactions respondents have executed include:
  - New "test" RFR facilities which acted as a 'toe in the water' for a corporate to learn how a SONIA loan would work
  - Legacy transactions which include wording to deal with LIBOR transition
  - Refinancing existing debt facilities, and using that opportunity to build in LIBOR transition wording
- A number of interviewees also noted adherence to the ISDA IBOR protocol as active steps being taken to deal with LIBOR transition for derivative products.

IBOR/LIBOR

Have you had discussions with any of your creditors about amending legacy contracts to include a risk free rate or other alternative rate?

57% YES

43% NO

Analysis

- The responses here are reflective of the steps taken by the banks in commencing LIBOR transition plans with corporate borrowers. Some banks have taken proactive steps, whilst others are yet to formally communicate with their borrowers. The approaches taken by banks also diverges, with some offering a degree of flexibility (and accompanying complexity), whilst others are offering more standardised but less flexible terms – in some cases which are not sympathetic to corporate borrowers.
- One notable feature is the need for corporate borrowers to be proactive with banks and make direct contact to commence LIBOR transition discussions - we would encourage all clients with LIBOR exposures to give this serious consideration, as the volume of LIBOR led amendments which must be executed this year are likely to place bank resources under significant strain and there are likely to major bottlenecks by the end of the year.

05

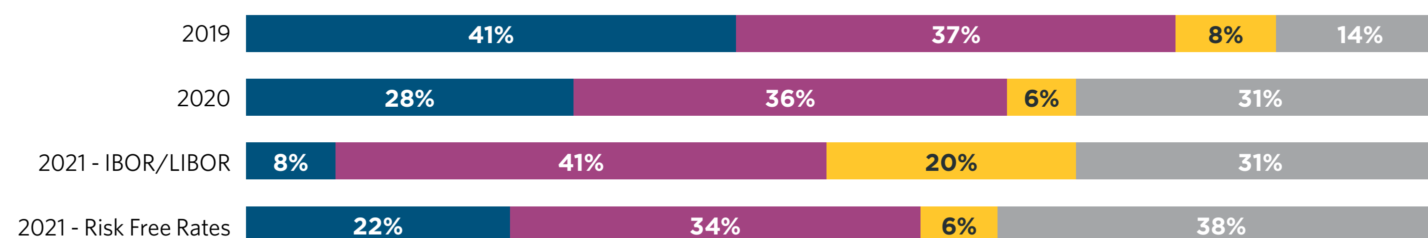
DERIVATIVES

5 DERIVATIVES

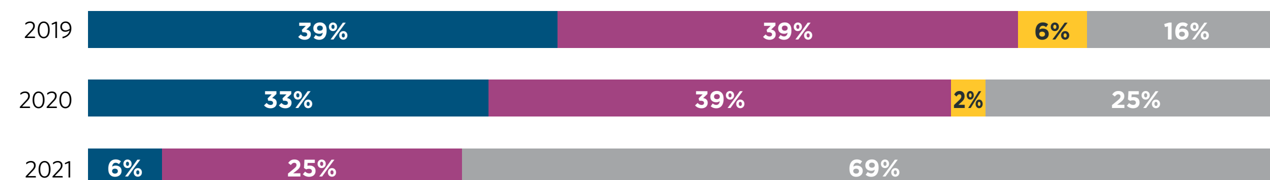
2021 DERIVATIVES FORECAST

Compared to 2020, do you anticipate that you will enter into more or less of the following treasury products in 2021?

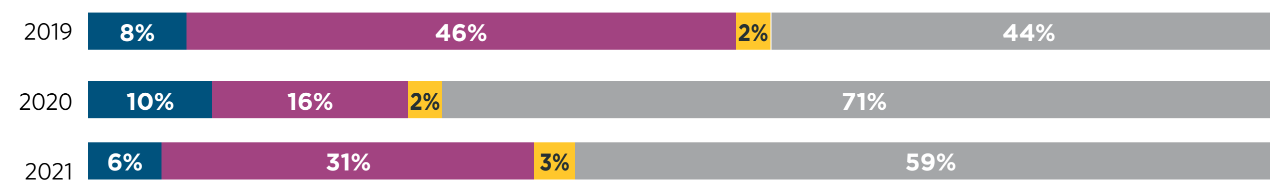
INTEREST RATE DERIVATIVES



CURRENCY DERIVATIVES



COMMODITY DERIVATIVES



More likely | No difference | Less likely | Do not use

Analysis

- The results of the survey indicate a marked change in the planned use of derivatives compared to 2019/2020, particularly in interest rate and FX derivatives.
- There is a significant decrease in the expected use of FX derivatives, with only 31% of respondents expecting to use FX derivatives in 2021 in comparison to over 70% in 2019/2020. This perhaps reflects market sentiment, particularly on Brexit, as sterling denominated businesses are more confident around sterling volatility. That said, there are many other global economic headwinds and uncertainties emerging in the short and medium term (including US and EU economic responses to the pandemic, trade difficulties between the US and China and volatility in emerging markets), which means the falling use of FX derivatives is striking. Interviewees noted "ever-increasing complexity" in accounting standards and possible reductions in international trade as further reasons for decreasing FX derivative usage.
- Similarly, a slight downward trend in the use of interest rate derivatives (an approximately 15% decrease from 2019/2020) might be driven by expectations of public funding and central bank interest rates remaining low in response to the pandemic. As a new segment, there are encouraging signs of the use of RFR derivatives as an alternative to LIBOR, although in line with general market experience volumes and take up remain low in this new asset class.
- The commodity derivative space does show signs of continuity, with similar levels from 2019/2020 to 2021. This shows the enduring need for corporates exposed to commodity price risk to actively hedge those risks, as the recent volatility in hydrocarbon prices clearly demonstrate.

06 BREXIT

6 BREXIT

BREXIT

How would you describe the impact to your business (if any) of the UK's exit from the EU and the new trading arrangements that apply:?

Analysis

- "Minimal" or a similar phrase was used to describe the impact of Brexit in 2/3 of survey responses.
- Those who did report adverse impacts pointed towards the delays in shipment of goods, pre-Brexit structuring costs, impact on workforce and efficiency of trading with the EU.
- There was a sense from respondents that, for most, there had been sufficient time to structure around the departure from the EU even if it meant that not all adverse consequences had been completely avoided.
- Looking back to our research in 2018, then 22% of respondents thought that in 2021 and beyond Brexit would have a negative impact on their businesses and this broadly appears to be the case though it remains to be seen how this develops and how material those negative impacts are.

"The work was done to make sure it was a non-event"

"Irritating but not significant (same for LIBOR)"

"Huge cost to prepare for something that simply adds complexity and no value"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

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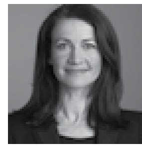

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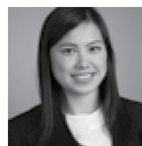

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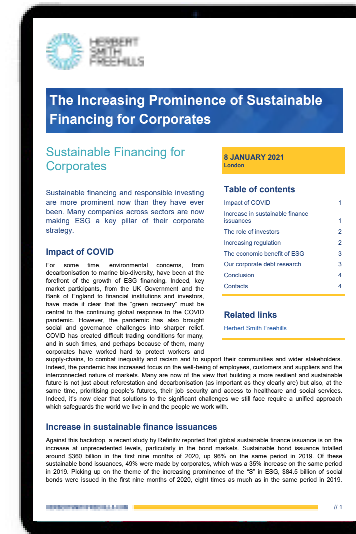

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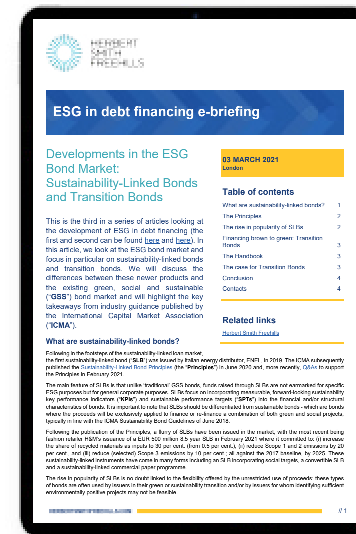

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