TRANSITIONING FROM WIBOR: IMPLICATIONS FOR POLISH DEBT CAPITAL MARKETS

Transition to WIRON

This briefing examines the impact of the transition from WIBOR to WIRON on the Polish debt capital markets and outlines what issuers and their advisers will need to consider as we approach end of WIBOR.

On 1 December 2022, GPW Benchmark, the administrator of benchmarks (including WIBOR), published the regulations for WIRON, which will replace WIBOR, long present in Poland. This completed the formal process of creating a new index. The impending end of WIBOR has also initiated a discussion among market participants as they need to prepare for the scenario that WIBOR will cease to exist.

As a result of the approaching discontinuation of WIBOR, the Polish Financial Supervision Authority (the "**PFSA**") created the Polish National Working Group for benchmark reform (Narodowa Grupa Robocza) (the "**NGR**"). The NGR is formed of a diverse group of market participants representing relevant sectors as well as representatives of the PFSA, the National Bank of Poland, the Ministry of Finance, the Bank Guarantee Fund, Warsaw Stock Exchange and GPW Benchmark. The NGR is the key forum for fostering the transition from WIBOR to WIRON, is open to financial market participants and other relevant stakeholders and publishes recommendations based on consensus. The activities of the NGR are overseen and coordinated by a steering committee composed of representatives of the PFSA, National Bank of Poland, Ministry of Finance, Bank Guarantee Fund, Polish Development Fund, GPW Benchmark and ING Bank Śląski, representing the banking sector.

The NGR published the roadmap for WIBOR transition which sets out key developments, deliverables and targets that are expected to be achieved with relation to benchmark reform in Poland[1]. According to the roadmap, new bonds linked to WIRON or new fixed interest rate bonds (including bank bonds, corporate bonds, and municipal bonds) should be issued in 2024 and the Polish market should be ready for a cessation of WIBOR by 2025.

As the roadmap is solely a non-binding step plan, the actual milestones may occur on different dates depending on market readiness and the actual progress of the work.

Key issues

- WIBOR is likely to cease to exist by 2025
- As WIBOR is a key benchmark for PLN bonds, the Polish National Working Group for benchmark reform was formed to navigate transition from WIBOR to WIRON
- Polish issuers and debt capital markets participants will need to carefully consider how this changing environment will impact new and existing capital markets documentation, particularly in respect of instruments maturing after the 2025 deadline for WIBOR cessation

[1] https://www.knf.gov.pl/knf/en/komponenty/img/mapa_drogowa_ang.pdf

New deals

With respect to new issuances of bonds, the Bonds Stream of the NGR prepared a recommendation on the application of the WIRON index in issues of floating rate debt securities which provides for the rules of calculating interest payments, a description of the recommended convention and the alternative convention and a comparative analysis of the selected conventions (the "**Recommendation**")[2]. The Recommendation is not obligatory, but Polish debt capital markets expect that issuers and other transaction parties will follow it as it is the result of a discussion amongst market participants.

Recommendation 1:

For the purpose of calculating interest payments for floating-rate debt securities, it is recommended that the compounded WIRON index is applied using a 5-business-day lookback with an observation period shift.

Recommendation 2.

The calculation of interest payments according to the recommended 'shift' convention should be performed as a quotient of the WIRON Compound Index value from the end and from the beginning of the observation period.

A computational methodology recommended in relation to WIRON is generally convergent with calculation conventions already adopted and tested by the European bond markets in relation to SOFR and SONIA i.e. risk free rates for U.S. dollar and Sterling, respectively. Whereas calculation conventions may include different "lookbacks", "observation period shifts", "lockouts" and "payment delays", a 5-business-day lookback with observation period shift is most often seen in medium term note (MTN) programmes as a methodology to obtain an average figure for a daily in-arrears above-mentioned risk free rates. As set out in the Recommendation, the 'shift' convention offers the best balance of economic appropriateness, being understandable to the user and interaction with the banks' and other stakeholders' systems.

In the transition period, issuers of new PLN bonds would be well-advised to aim for maximum flexibility to enable the newly issued bonds to adapt to the new world order, once it is ultimately known. As of today, the WIRON Compound Index could be included in the terms and conditions as a possible variant for the future. Importantly, the transaction parties should no longer rely solely on documentary fallback mechanisms originally drafted to mitigate against the temporary unavailability of WIBOR.

Implications for legacy transactions

Fallback mechanisms

The Recommendation addresses WIBOR transition issues for new issuances of debt securities, however, the discontinuation of WIBOR raises a number of issues for legacy transactions. Although legislative or regulatory solutions for legacy issuances are being considered, the prudent course of action is for issuers and their advisers to carefully consider how this changing environment will impact their existing bond documentation, particularly as the tenors of issued instruments are often likely to pass through the 2025 deadline.

Traditionally, Polish law governed terms and conditions included provisions which provide for a fallback mechanism which attempt to provide some

[2] https://www.knf.gov.pl/knf/en/komponenty/img/Recommendation_on_the_application_of_the_WIRON_index_in_issues_of_floatingrate.pdf

redress against the contractual uncertainty of a sudden unavailability of WIBOR at the relevant time. In summary, those provisions set out a process whereby, in such event, the calculation would request quotes from a predetermined number of reference banks based in Poland, and then use those to form the basis of a rate calculation. If, for any reason, such quotes could not be obtained, the rate of interest would default to the rate in effect on the immediately preceding interest rate period, leading to an effective transformation of the security into a fixed rate security.

From some time ago, when the benchmark reform with relation to IBORs started on other European markets and the trend of switching to risk free rates became apparent, Polish market participants and their advisers have begun developing more detailed fallback provisions. Typically, such fallback terms indicate an entity or an authority responsible for determining an alternative or successor rate, together with an adjustment spread, on the occurrence of certain "benchmark events". These events include the cessation of the publication of WIBOR and it being unlawful for the issuer or any of its agents to calculate payments using WIBOR. The benchmark events also include certain pre-cessation triggers which aim to anticipate the benchmark discontinuation, including public statements by GPW Benchmark, the administrator of WIBOR that WIBOR will cease to be published, will be permanently or indefinitely discontinued or otherwise be prohibited from use. There is no prescribed form for these provisions, although market practice does appear to be quite consistent in indicating the sequence of authorities accountable for recommending an alternative rate and adjustment spread. Typically, such list included the Polish Financial Supervision Authority, the National Bank of Poland, GPW Benchmark as an administrator of WIBOR or an entity recommended by any of the above.

Statutory replacement of benchmark

According to Regulation 2021/168 amending Regulation 2016/1011 (the "**Amending Regulation"**) which came into force on 13 February 2021, in case a systemically important benchmark is no longer in use a statutory replacement benchmark can be put in place.

A statutory replacement benchmark applies if, inter alia, a relevant contract or financial instrument do not contain fallback provisions or do not contain suitable fallback provisions. In such cases, the designated benchmark will replace a benchmark which has been discontinued. The power to designate one or more statutory replacements for a benchmark shall be vested in the competent national authority. Also, according to the Amending Regulation, the parties may agree to apply a different replacement for a benchmark to the one designated by the competent national authority.

On 9 June 2022, the lower Chamber of Polish Parliament passed the Act on Crowdfunding for Business Ventures and Assistance to Borrowers (Ustawa z dnia 9 czerwca 2022 r. o finansowaniu społecznościowym dla przedsięwzięć gospodarczych i pomocy kredytobiorcom) which contains provisions related to the liquidation of WIBOR. The provisions of the Act introduce a procedure to implement a statutory replacement of benchmark by national law. In the event of such circumstances, the PFSA will present the Financial Stability Committee (Komitet Stabilności Finansowej) with its position containing information on the necessity (or lack thereof) of designating a replacement benchmark, together with the spread adjustment that is to be applied to the replacement for a benchmark the use of which is to cease. After receiving the position of the PFSA, the Financial Stability Committee will either issue a recommendation stating the need to designate a replacement or will refuse to issue such a recommendation. If there is a need to designate a replacement, the minister in charge of financial institutions may specify the replacement, the spread adjustment, the corresponding essential conforming changes and the date from which the replacement for a benchmark applies.

The designation of a statutory replacement benchmark could be helpful in terms of the long-term transition from WIBOR. However, as of now, there is no certainty as to how it will be applied. There is also no clear guideline in what circumstances particular fallback clauses would not meet the suitability criterion referred to in the Amending Regulation.

Possible options

1. Bondholders resolution

For floating rate notes already in issue, which have a maturity date following the 2025 deadline, it may be worth considering convening a bondholders' meeting in order to replace the existing WIBOR with the WIRON computation. Such bondholders' resolution would relate to interest payment conditions so it would constitute a qualified provision under the Polish Act on Bonds. As a consequence, in the case of bonds admitted to trading on a regulated market or introduced into an alternative trading system, the consent of all bondholders present at the meeting of bondholders is necessary. Although seeking such consent may be challenging, if no such change is made to the terms and conditions, there could be a risk that following the 2025 deadline, a floating rate security will 'convert' into an essentially fixed rate security or that the statutory replacement benchmark will apply. Based on the European experience, it may therefore be feasible for issuers to obtain bondholders' consent without the need to offer huge consent fees as an incentive for amendments to terms and conditions relating to the rate of interest. Bondholders may already be sufficiently incentivised to support a resolution which will ensure that their investment remains linked to an adequate underlying rate which is commonly agreed.

2. Call option mechanism

Polish bond documentation quite often includes the issuer's call options, exercisable either from the issue date or after a specific period of time. Such provisions are designed to provide an issuer with a right to redeem the notes earlier than anticipated and typically include a premium if such option is exercised by an issuer. The premium most often varies depending on the period remaining to the maturity date.

Uncertainty and challenges relating to the WIBOR replacement may cause issuers to consider the possibility of exercising their call options in the case of bonds maturing after the 2025 deadline, particularly if obtaining consent from each bondholder may not be feasible.

3. Refinancing

While a call option can be helpful, it is not always included in the relevant terms and conditions or for many reasons it may not be advisable for an issuer to exercise its call option at the relevant time. The process of convening a bondholders' meeting can be long and obtaining consent can be very expensive. Against this backdrop, the WIBOR transition may play an important factor in identifying a suitable refinancing strategy. Although issuers are now facing quite significant credit charges and are affected by the high interest rate environment, it can be worth weighting those risks against the potential costs and uncertainty related to the WIBOR replacement. In particular, a redemption of existing bonds and new issuance of bonds including the WIRON Compound Index can be a good solution in case of debt maturing in the next few years, which will anyway require refinancing.

Conclusions

The documentary, administrative and commercial challenges involved in adopting any replacement rate for new deals and amending any legacy bonds to address the cessation of WIBOR should not be underestimated. Time is short: notwithstanding the outstanding uncertainties discussed in this briefing, in all probability WIBOR will no longer exist by the end of 2025. The Polish debt capital markets cannot afford to be left behind. Among the options available to issuers are seeking bondholders' consent, exercising a call option, refinancing or waiting for a legislative solution or a recommendation from the NGR. Whatever approach will be taken by an issuer, first of all it is recommended to identify contracts and financial instruments for which WIBOR cessation is an issue, review all of their fallback clauses and then consider what would be the best course of action depending on the existing fallback mechanisms, market developments and the general financial strategy of a given issuer.

This briefing looks at the challenges ahead but does not contain any detailed analysis or consider the consequences of WIBOR cessation under any existing bond documentation. We would however be happy to advise on any questions you may have concerning this issue. Feel free to contact any one of us or speak with your usual Clifford Chance contact.

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