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LIBOR Transition FAQs

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With the use of LIBOR being phased out by the end of 2021 and its prevalence in corporate loans, adjustable-rate mortgages, floating rate notes, securitized products and derivatives products, nearly all lenders and borrowers will be impacted. Husch Blackwell attorneys have put together responses to frequently asked questions related to the LIBOR transition.

What is LIBOR?

The London Interbank Offered Rate (LIBOR) is a benchmark interest rate at which major global banks lend to one another in the international interbank market for short-term loans, published daily by the Intercontinental Exchange (ICE). The Alternative Reference Rates Committee (ARRC) estimates that current outstanding contracts referencing U.S. Dollar LIBOR, including corporate loans, adjustable-rate mortgages, floating rate notes, securitized products and derivatives products totals nearly $200 trillion.

When will LIBOR rates no longer be published?

On March 5, 2021, ICE and the Financial Conduct Authority (the FCA) confirmed that most tenors of U.S. Dollar LIBOR would cease being published on a representative basis on June 30, 2023. One-week and two-month LIBOR will cease being published December 31, 2021.

When should lenders cease making LIBOR-based loans?

The Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) issued a statement on November 30, 2020 encouraging banks to transition away from LIBOR as soon as practicable, but in any event by December 31, 2021. The agencies believe entering into new contracts that use LIBOR as a reference rate after December 31, 2021 “would create safety and soundness risks and will examine bank practices accordingly.” ARRC

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suggests that lenders transition away from new loans referencing LIBOR by June 30, 2021.

What should be included in new loan documents executed in 2021?

The joint statement issued by the Federal Reserve Board, OCC, and FDIC advised that new contracts entered into before December 31, 2021 should either utilize a reference rate other than LIBOR or have robust fallback language that includes a clearly defined alternative reference rate after LIBOR's discontinuation.

Are the agencies mandating a specific replacement for LIBOR?

In its November 6, 2020 joint statement, the Federal Reserve Board, OCC, and the FDIC noted that the agencies do not intend to recommend a specific credit-sensitive rate for use in place of LIBOR. The agencies recommended that financial institutions "use any reference rate for its loans that the bank determines to be appropriate for its funding model and customer needs."

What are possible replacement rates for LIBOR?

Many existing loan documents include a fallback to the Prime Rate if LIBOR ceases to be available. ARRC has proposed "hardwired" replacement rate provisions which would use the Secured Overnight Financing Rate (SOFR) as the replacement for LIBOR. ARRC was established by The Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York in 2014 to develop best practice recommendations in identifying potential alternative reference rates for LIBOR.

What are possible mechanisms to replace LIBOR?

Loan documents may take the "amendment approach" whereby the lender may amend the documents to replace LIBOR when appropriate, subject to borrower consent rights, as negotiated between the parties.

ARRC has promulgated suggested "hardwired" language which provides for the automatic replacement of LIBOR with SOFR upon certain triggering events.

What is SOFR?

The Secured Overnight Financing Rate (SOFR) represents the interest rate that banks impose on each other in making loans secured by U.S. treasuries. SOFR is a daily, overnight rate, released by the Fed every morning. SOFR may include:

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"Term SOFR" would operate similar to LIBOR, in that it would be a forward-looking rate representing a projection of what daily SOFR would be on a certain date in the future. Term SOFR is not yet available as an index, and will not be until a more active swap market exists for daily SOFR.

"Daily Simple SOFR" or "SOFR in Arrears" is a "lookback" rate based on daily SOFR rates that have occurred prior to the relevant interest payment date, and would be an average of the daily SOFR rate for each day over the preceding period (for example, one month).

How are LIBOR and SOFR different?

LIBOR is currently published as a forward-looking rate (one month, three months, etc.), while SOFR is not. LIBOR is meant to represent a bank's cost of capital, while SOFR measures rates applicable to short-term, secured financing.

How does the ARRC "hardwired" approach work?

ARRC's hardwired approach uses a three-step waterfall to determine the replacement rate for LIBOR. Once an event triggering the need to replace LIBOR occurs, the lender would replace LIBOR according to the following waterfall:

> **Step 1:** Term SOFR plus the relevant spread adjustment. As noted above, Term SOFR is not yet an available rate, although it may become available before LIBOR ceases.
>
> **Step 2:** Daily Simple SOFR plus the relevant spread adjustment. If Term SOFR is not available, Daily Simple SOFR (aka SOFR in Arrears) plus a spread would be used.
>
> **Step 3:** If SOFR is not available, borrower and lender select a replacement rate, similar to an "amendment approach."
>
> *Note: language may be included to "climb the waterfall" back to Step 1 (Term SOFR) if that rate later becomes available.*

How will the spread adjustment be determined when using SOFR?

Since SOFR is an overnight, secured rate, it has historically been a lower rate than LIBOR. Therefore, a "spread adjustment" will be necessary when converting to a SOFR-based rate. ARRC recommends using a spread adjustment based on a five-year historical median between LIBOR and SOFR.

What would trigger converting from LIBOR to SOFR?

Per ARRC's hardwired language, announcements by relevant regulatory agencies and industry bodies that LIBOR will no longer be published would begin the process of the switch from LIBOR to SOFR.

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Lender and borrower may also choose an "early opt in" which would permit an earlier switch to SOFR. On March 9, 2021, ARRC confirmed that ICE's announcement of a definitive cessation date for LIBOR tenors constituted a "Benchmark Transition Event," beginning the process of switching from LIBOR. While a "Benchmark Transition Event" does not require an immediate transition under the ARRC-recommended fallback language, it does signal that the "Benchmark Replacement Date" is expected to be on or immediately after the following dates for LIBOR: (i) December 31, 2021 for 1-week and 2-month LIBOR, and (ii) June 30, 2023 for Overnight, 1-month, 3-month, 6-month, and 12-month LIBOR.

What if my existing loan documents already provide for the lender to select a replacement rate when LIBOR is no longer available?

ARRC recommends in its best practices guidance that the lender should disclose its planned selection to relevant parties at least six months prior to the date that a replacement rate would become effective.

Additionally, lenders should consider adding more robust fallback language if there is an opportunity for loan document amendment.

What should a lender consider now?

1. Prepare for the cessation of LIBOR by including robust replacement language in new loan documents (whether amendments or new credit facilities).
2. Review existing loan portfolio to ensure adequate rate transition language is included for all loans.
3. Prepare internal operations for transition to SOFR, if applicable.

Contact us

For more information, contact Paul Dombrowski or your Husch Blackwell attorney.

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