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WHAT NOW? LIBOR TO BE PHASED OUT BY 2021

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The United Kingdom Financial Conduct Authority has announced it will phase out the London Interbank Offered Rate (LIBOR) by 2021, putting an end to the governing global borrowing index which, for the last 50 years, has supported trillions of dollars in financial instruments. LIBOR is a figure determined daily by a select group of creditworthy international banks, based upon what those banks would charge each other for large loans, and as a result has been used by private and public lending institutions to govern variable-rate transactions since the 1950s. Currently, LIBOR underpins an estimated $350 trillion of financial contracts, mortgages, bonds, bank deposits, mutual funds and loans.

Critics of LIBOR have long bemoaned the fact that the index relies upon bank experts' best guesses or theories, rather than actual transactional evidence. In 2014, the Federal Reserve set up the Alternative Reference Rates Committee (ARRC) to implement an alternative reference rate, which led to two options that could provide more real-time, market-reflective data than LIBOR: (1) the Sterling Overnight Average Index (SONIA); and (2) the Secured Overnight Financing Rate (SOFR).

The Federal Reserve Bank of New York, in cooperation with the U.S. Treasury Department's Office of Financial Research introduced SOFR in March of 2018, and United States Regulators have honed in on SOFR as the next step to transition trillions of dollars in securities away from LIBOR. SOFR's advantages over LIBOR include securitization (repossession refinancing rate is derived from collateralized assets), immediate market indicators (SOFR is an overnight rate, based on overnight loans – contrast this with LIBOR, which covered loan maturities ranging anywhere from one day to one year), and increased volume (trading under SOFR in 2017 exceeded $700 billion daily, while the three-month LIBOR is approximately $500 million).

Here are some helpful guidelines for borrowers and lenders with a contract, mortgage, bond, or loan that may be based, at least in-part, upon LIBOR:

- Go back and review your loan documents to determine how they address the calculation of interest rates in the absence of LIBOR. Do the documents address how to transition to an alternative reference rate? What are each of the party's rights in the event LIBOR is no longer available?
- If LIBOR no longer reflects the intent of the parties or accurately represents the previously agreed upon rates, consider discussing the interest rate with the borrower or the lender to determine viable substitute options regarding the prevailing interest rate of the governing documents. Many financial instruments provide contractual alternatives in the event the variable rate indices are dubious or do not provide an accurate reflection of the current state of the market
- Parties should consider implementing an alternative method now for calculating interest, in order to avoid confusion once LIBOR is no longer available
- If you have any questions, consider contacting the attorney who negotiated and/or closed the transaction, or, if you did not use an attorney, consider hiring legal counsel to review the documents if the interest rate terms are silent or ambiguous
- Contact the mortgage broker (if applicable) who assisted in loan origination.

The phase-out of LIBOR is essentially right around the corner. The time is now to fully prepare for this eventuality and consider putting into place protections for the uncertainty ahead.

For more information, please contact the author Josh Brandsdorfer on our Business, Finance & Tax Team.

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