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THE END OF LIBOR

LIBOR, or the London Interbank Offered Rate, is the market standard for pricing financial assets, including credit cards, syndicated loans, and swaps and other derivatives, with some $350 trillion in financial products pegged to LIBOR.

LIBOR measures the rate at which banks can borrow from one another on a short-term, unsecured basis. Specifically, LIBOR is an interest rate to borrow money over a specified period (ranging from overnight to one year) set by several leading London banks. Each bank estimates the interest rates it would be charged to borrow money from another bank for the applicable period, and the average of those estimates is compiled and published daily.

On July 27, 2017, the UK's Financial Conduct Authority (FCA), which oversees LIBOR reporting, announced that the FCA will no longer require banks to submit quotes for LIBOR rates by the end of 2021, meaning that LIBOR will be phased out by the end of 2021.

Although there is currently an effort underway to identify one or more successors to LIBOR, there is not yet any clear consensus on a replacement rate.

One possible replacement is a new, broad Treasuries repurchase financing rate, which has been recommended by the Alternative Reference Rates Committee, a consortium of U.S. regulators and market participants convened by the Federal Reserve in November 2014. This new rate would be linked to the cost of borrowing cash secured against U.S. government debt and would reflect the rate charged for interbank overnight loans secured by treasuries.

Another possible replacement is the Overnight Bank Funding Rate, an unsecured bank lending rate published by the Federal Reserve and calculated using federal funds transactions and certain Eurodollar transactions.

In light of the pending demise of LIBOR and the current uncertainty regarding a new benchmark, there are things that lenders and others should do now. Specifically, existing loan agreements that mature after 2021 and reference LIBOR should be reviewed to determine whether they include any fallback

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provisions for determining a substitute benchmark rate if LIBOR is discontinued. These fallbacks, if present, are generally designed for temporary disruptions rather than a full transition away from the use of LIBOR as a benchmark. Rather than relying solely on these fallback provisions, loan agreements should also be reviewed to assess the feasibility of amending the agreements prior to 2021 to provide for an alternative benchmark and pricing. Such amendment cannot simply substitute a new benchmark for LIBOR, as the new benchmark might routinely produce lower or higher rates than LIBOR. Therefore, in addition to changing the benchmark, the parties may want to also change the margin, to ensure they get to the same economic position once they start using the new benchmark.

Any new loan agreements that involve LIBOR that potentially extend beyond 2021 should take into account the LIBOR phase-out, either by substituting a different benchmark, or giving the parties broad discretion to select a replacement benchmark to be used when LIBOR is no longer available, since it will not be clear for some time what replacement benchmark rate will be used as LIBOR is phased out. Although 2021 is still some years away, lenders and borrowers can take steps now to proactively prepare for the end of LIBOR.

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