TRANSITION FROM LIBOR

In July of 2017, the United Kingdom Financial Conduct Authority, the regulator of the London Interbank Offered Rate (LIBOR), announced that LIBOR will phase out at the end of year 2021. The reason for discontinuing LIBOR was due to the high level of manipulation of the rate that had been exposed in 2012, which dates back to as early as 2003.

LIBOR is determined using a submission of rates from a reference panel of somewhere between eleven and sixteen banks. Some banks in the reference panel reported artificially low or high interest rates in order to swing LIBOR in their favor. This continued without detection for nearly a decade, without much effort by the financial institutions causing the manipulation. The LIBOR scandal ultimately resulted in approximately **$9 billion in fines** on the financial institutions involved, and most importantly, showed a clear weakness in an internationally used reference rate.

With the discontinuance of LIBOR, the main question becomes: what rate will financial institutions refer to moving forward? In order to answer that question and determine an alternative to the LIBOR, the Board of Governors of the Federal Reserve System sponsored a committee called the Alternative Reference Rates Committee (ARRC).

In March 2018, ARRC determined that the Secured Overnight Financing Rate (“SOFR”) would be the best replacement for LIBOR. As of April 3, 2018, the Federal Reserve Bank of New York started publishing SOFR rates daily in an effort to allow for instant transitions for new loan documents being entered into. Although the transition isn’t mandatory until LIBOR phases out at the end of 2021, financial institutions must start preparing new loan documents now, as the majority of notes being entered into today are going to mature after December 31, 2021, and, therefore, will not be able to rely on LIBOR for the latter part of the loan.

ARRC has recommended language to incorporate into new loan documents in order to smoothly transition from LIBOR to SOFR. The committee has also given advice on how to handle currently active loan documents that reference LIBOR, but will not mature until after December 31, 2021. Our firm has experience in drafting new loan documents to incorporate the new reference rate, and can provide guidance on how to handle currently active loan documents with reference to LIBOR. For more information on this topic, contact us here.

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