The Financing Advisor SHULMAN ROGERS

ARE YOU PREPARED FOR LIBOR TO BE PHASED OUT?

The London Interbank Offered Rate, or “LIBOR”, as most commonly known in the banking world, is a reference rate or index typically used to determine the interest rate to be charged for loans to borrowers. On July 27, 2017, the Financial Conduct Authority of the United Kingdom announced that LIBOR will be phased out and ultimately eliminated by the end of 2021. This may not be a surprise to many banks and lenders but, given the recently publicized scandals involving LIBOR, it raises concerns with respect to existing loans and new loans with maturities beyond 2021 that use LIBOR as a reference rate. We will discuss below some alternatives to ease the transition away from LIBOR, and ways lenders can protect themselves with respect to loans already in place that use LIBOR as a reference rate.

Alternative Indexes

The good news is that lenders will have almost five years to completely transition from using LIBOR to an alternative index. This provides lenders time to consider and ultimately adopt a new reference rate (and change all of their back office systems to accommodate the new index). The timeline gives lenders a head start in evaluating the value and effectiveness of alternative benchmark index rates. In addition to examining existing alternative reference rates (i.e. Prime, U.S. Treasuries, etc…), there have been global discussions among banks toward the development and implementation of new alternative benchmark interest rates that should become available shortly for consideration. In late 2014, in anticipation of the possible elimination of the U.S. Dollar LIBOR, the Federal Reserve Board formed the Alternative Reference Rates Committee (“ARRC”) to review the development of more stable alternative indexes. Earlier this year, the ARRC announced its selection of a broad Treasury financing rate (based on short-term transactions secured by Treasury securities) as its preferred alternative reference rate, albeit to be used exclusively for repurchases of derivatives and other financial contracts. The ARRC will be working through the end of this year to refine and publish its report on the proposed transition to and implementation of this preferred alternative.

Loan Documentation

In the meantime, you should take steps toward a smooth transition away from the LIBOR rate. Consider having an audit conducted of your existing loan documentation for LIBOR-based loans to confirm that there is sufficient and adequate language allowing the lender full discretion to choose an alternative index in the event LIBOR becomes unavailable or cannot be calculated. We recommend having robust and detailed provisions describing how the alternative index is chosen, and the level of discretion the lender has to choose the alternative index. Either specify the replacement index upfront, or if that is not feasible, direct that the lender has sole discretion in choosing a comparable index to avoid a prolonged negotiation with borrowers over what would be appropriate. It would be wise to have legal counsel review your standard alternative index provisions to confirm that they allow the lender sufficient discretion to determine an alternative index and to note any lender obligations (i.e. advance notice to the customer, etc.) in doing so. We also suggest a review of the loan documents for all existing loans either maturing or being extended beyond 2021 in order to confirm that the documents contain adequate alternative index language. The alternative index language contained in most loan documentation today was intended to address the unavailability of LIBOR due to a temporary market disruption, and more specific provisions may need to be drafted to address the phase out of LIBOR altogether. Lenders should take advantage of this time to make any necessary modifications to loan documents that may be inadequate to support a smooth transition to the new index.

If you would like more information or assistance in reviewing and revising your existing loan documents for the upcoming transition, please do not hesitate to contact Matthew S. Bergman, Esq. directly by telephone at (301) 255-0529 or e-mail to mbergman@shulmanrogers.com or Steven W. Walter, Esq. at (301) 945-9243 or swalter@shulmanrogers.com.

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