KRIEG DEVAULT

Insights

Secured Lender Alert: LIBOR Replacement

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Background

As has been widely reported, LIBOR is expected to be phased out by the end of 2021. With no readily available replacement, it has been left to market participants to develop and transition to alternative reference rates and to determine a transition plan.

In the United States, the Federal Reserve (FR) created the Alternative Reference Rates Committee (ARRC) to identify an alternative benchmark rate. In December 2017, the FR announced that it will publish three LIBOR replacement rates starting in 2018, all of which are based on trade-level data from various segments of the repurchase agreement market. Of these three rates, the Secured Overnight Financing Rate (SOFR) (also sometimes referred to as the broad Treasury-backed financing repo rate (BTFR)), is the ARRC's preferred LIBOR alternative. The ARRC has formulated a paced transition plan with an end-of-year 2021 anticipated completion date that culminates in the creation of a term reference rate based on SOFR-derivatives markets once liquidity has developed sufficiently to produce a robust rate.

Legacy Credit Facilities

Until the SOFR or another alternative reference rate becomes accepted in the market, lenders are faced with two issues: (1) what to do with legacy credit facilities which utilize LIBOR-indexed pricing; and (2) what to do with credit facilities being documented during the interim period prior to the phase out of LIBOR, but prior to the SOFR becoming the market standard replacement rate.

In legacy credit facility loan documents, fallback provisions often have practical limitations in the absence of agreed alternatives to LIBOR. For example, current market standard loan documents often include language that addresses the possible discontinuance of an interbank rate for a specific currency or maturity or the unavailability of a particular source for the publication of LIBOR, but do not contemplate the complete discontinuance of LIBOR. Other provisions specify that if LIBOR is not ascertainable, the loan will convert to the prime rate or fed funds rate plus or minus a stipulated margin. These alternative rates are typically more expensive than LIBOR rates so that this is not a long-term solution for legacy credit facilities.

Thus, lenders should review their existing loan documents to determine whether they include a sufficiently broad fallback provision or suitable substitute rate that will not send the borrower shopping for a refinance. If not, then an appropriate amendment may be the answer.

Pending Credit Facilities

In pending credit facility loan documents and in any amendment of a legacy credit facility, the challenge is this: how can a lender specify the use of a future alternative reference rate which does not exist and which does not yet have market acceptance? While we see lenders continuing to use LIBOR as an index rate for pricing, lenders are taking various approaches for loans that mature after 2021. Benchmarking can help your institution ensure that its approach is market.

If you have any questions or would like assistance in reviewing your existing loan documents or benchmarking for eventual LIBOR phase-out, please contact Lori Jean, or any other member of the Krieg DeVault Commercial and Real Estate Lending group.