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Commercial Loan Borrowers: LIBOR is Going Away

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The London Interbank Offer Rate (LIBOR) will no longer be published by end of 2021 or possibly even sooner. What does this mean for existing and new commercial loans with interest rates based on LIBOR?

This issue has been studied for several years by the Alternative Reference Rates Committee (ARRC) – a committee organized by the Federal Reserve Board to make recommendations. The ARRC has over the past couple of years issued a number of reports containing recommendations for various types of loans.

On November 30, 2020, the Fed and the Federal Reserve Bank of New York issued a statement that included this language:

“Therefore, the agencies encourage banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021, in order to facilitate an orderly—and safe and sound—LIBOR transition. New contracts entered into before December 31, 2021 should either utilize a reference rate other than LIBOR or have robust fallback language that includes a clearly defined alternative reference rate after LIBOR’s discontinuation.”

The ARRC has recommended the Secured Overnight Financing Rate (SOFR) as a replacement rate. That is the rate at which US banks borrow money from other banks on an overnight secured basis and is suggested as an index which is expected to most closely resemble Libor-based rates. However the Fed has stopped short of mandating the SOFR as a replacement rate. And the Fed has not told banks how it should document any replacement rate.

It is unclear at this point when banks will implement a replacement to LIBOR and how that will be documented. Many documents allow lenders to implement alternate rates when the lender deems LIBOR unreliable, which may occur before the

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actual discontinuance of LIBOR reporting.

It appears that some banks will use a letter agreement to do this and others may do so by amending the loan documents. It should also be noted that many loan documents contain “alternate rate” language which may index a rate much less favorable than LIBOR and frequently drafted as more of a default rate with the assumption that LIBOR is no longer available due to a financial crises, than as a replacement rate index.

What is clear now is that banks will need to document the rate change for many, many LIBOR borrowers in the next few months. It would be wise to contact your bank well in advance of the end of 2021 to initiate whatever loan document changes the bank will implement. We plan to keep our clients updated as this progresses so that you are making the best informed business decisions for your individual circumstances.

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