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End of LIBOR – Part 3 – The Final End is Near

Client Alert

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As we previously reported in our “End of LIBOR – Part 2”, for several years US banking regulators have been preparing for the replacement of the London Interbank Offer Rate (LIBOR) as a lending index rate. This has been a major undertaking as LIBOR is the index on an estimated \$400 trillion of financial products. All tenors of the LIBOR index will no longer be available after **June 30, 2023**. Additionally, regulatory agencies around the globe made clear that no new or renewed contracts are permitted to use LIBOR going forward.

Who Does This Affect? These issues and each lender’s transition plans are of significant import to borrowers whose LIBOR-based loans or swap agreement straddle the LIBOR expiration dates (“legacy loans”), as each set of loan documents determines the “alternate rate”, in the event that LIBOR is no longer available or deemed by that lender reliable.

Why Is This Important? Many alternate rate provisions are drafted under the presumption that if a LIBOR based index rate is no longer available, there are serious financial market instabilities and the alternate rate is a much less favorable index, such as a prime rate index + bps or a percentage. Further, existing LIBOR-based swap agreements are unclear on the calculation of termination fees in the event LIBOR is no longer available to do so.

What Is the Replacement Rate? Under the auspices of the Federal Reserve Bank of New York, a working committee was formed to make recommendations regarding possible replacement indexes and the transition away from LIBOR. This committee – the Alternative Reference Rates Committee (“ARRC”) – has issued many detailed reports and recommendations. In particular, the ARRC recommended (but did not mandate) that the Secured Overnight Finance Rate (**SOFR**) become the replacement index rate, however, each

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lender has adopted its own procedures and replacement rate index. The replacement rate indexes we are seeing from lenders are SOFR and BSBY. Some lenders are supporting either SOFR or BSBY, while others may support both indexes.

What Are SOFR and BSBY? The Bloomberg Short-term Bank Yield (**BSBY**) index is a credit sensitive, short-term bank yield index. Developed by Bloomberg, this index is based on transaction-related data, including both actual executed transactions and firm, executable quotes (over \$150 billion in transactions). SOFR is calculated as a volume weighted median of transaction level tri-party repurchase agreement (repo) transactions data. The SOFR market is very liquid with approximately \$1 trillion of trading daily.

What Do We Do? If you have a “legacy loan”, you will want to speak with your lender about their chosen alternate rate index and transition plan. We suggest you leave ample runway for you to plan and coordinate an orderly transition with your lender and avoid a fire drill as June 30, 2023 approaches.

For more information please contact your Butzel attorney or the authors of this Client Alert.

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