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LIBOR Transition Within the Context of COVID-19

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Amid the Coronavirus Disease 2019 (COVID-19) pandemic, “steady as she goes” seems the current position of the different regulators in charge of coordinating an orderly transition from LIBOR to alternative reference rates, in particular, after the UK’s Financial Conduct Authority (FCA) confirmed on April 29, 2020, that “firms cannot rely on LIBOR being published after the end of 2021”.

Notwithstanding that the FCA has extended the deadline for ending the use of the LIBOR interest rate benchmark in new loans until the end of March 2021 (from September 2020), giving more time to banks already dealing with COVID-19-related issues, the FCA has stayed course and not extended the use of LIBOR past the original deadline of end of 2021.

Meanwhile, authorities around the world are preparing for the discontinuation of LIBOR as originally announced. For example, regulators in Australia and South Korea have encouraged market participants to assess their exposure to LIBOR and begin their transition to alternative rates. In the United States, the Alternative Reference Rates Committee (ARRC) (convened by the Federal Reserve Board and the New York Fed) continues to chart the course by providing its own list of objectives for 2020 and a list with recommended best practices for the cessation of U.S. dollar LIBOR , “doubling down” on its early decision to use the Secured Overnight Financing Rate (SOFR) as the alternative rate for the U.S. market after LIBOR is no longer quoted. In addition, questions persist in the United States about the viability of SOFR given recent volatility and the lack of a forward-looking term SOFR rate.

It is possible that the FCA will not further extend the use of LIBOR, and that the ARRC will not select a different rate as the recommended alternative reference rate. However, the FCA and/or ARRC may change their minds. For example, if SOFR spreads widen considerably from LIBOR during this economic crisis, as they did in a backtrack calculation during the 2008 Financial Crisis, pressure may grow from market participants to find an alternative rate. Further, some of the COVID-19 stimulus loan programs in the United States, intended to provide relief and liquidity during the crisis, are currently indexed in LIBOR (and not SOFR), because “quickly implementing new systems to issue loans based on SOFR would require diverting resources from challenges related to the pandemic.” (see question G.3 in the Federal Reserve’s FAQs in connection with The Main Street Lending Program).

The crisis created by COVID-19 has made market participants change priorities to address more urgent matters, and has placed transition efforts on the back-burner. As such, banks and other market participants may not be working to determine their exposure to existing contracts referencing LIBOR, outlining plans of action, changing internal models, modifying their operational systems, and further, engaging counterparties in renegotiating – when necessary – documentation that may not properly provide for a useful alternative reference rate.

COVID-19 disrupted the world as we know it. With economies around the world having to adapt to a new reality, financial institutions may wish to prioritize plans related to an orderly transition to alternative reference rates. Indeed, pre-cessation triggers may hit before 2021 if LIBOR becomes unrepresentative of London interbank offered rates. In such a case, the LIBOR disruption may occur well before it was planned by any market participant.

Read GT’s LIBOR Transition Newsletter, where we provide updates, analysis, and occasional commentary on the latest developments relating to the highly anticipated phasing-out of LIBOR at the end of 2021 – just 19 months from now.

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