Keep Moving With LIBOR's Transition

hedging SOFR pandemic

Summary: The coronavirus has been on top of mind lately, yet the transition of LIBOR has not been delayed. We provide steps to keep moving forward with your plans.

Something we found surprising is that Queen Elizabeth is a trained mechanic. While you ponder that strange fact, we hope you don't find the transition from the London Interbank Offered Rate (LIBOR) surprising.

LIBOR's days are numbered, as the clock continues to tick towards its December 31, 2021 expiration. Though COVID-19 has turned the focus to a myriad of new challenges, there has yet to be an announcement delaying the transition. If community financial institutions (CFIs) want to ensure they are aware of their total LIBOR exposures, they need to continue moving forward with their transition plans.

COVID-19 has definitely changed the way organizations are looking at LIBOR's most likely replacements and has raised concerns regarding how the spread adjustments for alternate benchmarks will be calculated. At the heart of such concerns is that the coronavirus has knocked spreads between term rates in the current market and overnight alternative reference rates (ARRs) out of whack, creating uncertainty around how and if such spread inequities should be incorporated into long-term calculations. Add to that the various measures taken globally to offset the impact of the pandemic -- measures such as the impact payments and bolstered unemployment benefits -- which are artificially impacting the economy and making the current situation even more complex.

The Secured Overnight Financing Rate (SOFR), the alternative to LIBOR, has fared well so far during COVID-19. There are a handful of primary ARRs that financial institutions are reviewing as benchmarks, such as the fed funds rate, prime rate, etc. Whichever benchmark organizations choose to use though, they need to keep in mind that ARRs are controlled by various organizations and some are not necessarily ready to take over for LIBOR just yet. Further, many ARRs do not take into account market risk as a factor for volatility during turbulent times in the way that LIBOR does.

Faced with so much uncertainty, when it comes to their own LIBOR transitions, CFIs should be looking closely at all exposures they have to LIBOR to determine the risks -- including any exposure that may be hidden within third-party contracts. To help you with this transition, we provide you with some other areas to cover.

1. **Determine which agreements have LIBOR** benchmarks and review any contracts that mature after 2021 for provisions regarding ARRs related to LIBOR's discontinuation.
2. In the case of new contracts that involve LIBOR, there should be references to **ARR fallback provisions**.
3. **Assess any liabilities** that may arise due to the change in interest rates that LIBOR's discontinuation may create.
4. **Re-assess back-office processes** and make adjustments whenever/wherever necessary.

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