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4 FAQs about the end of LIBOR

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Financial institutions and borrowers around the world are facing the reality of a likely elimination of the LIBOR index. With calls to end LIBOR by 2021, here are four questions many are asking.

1. **What is LIBOR and why the call to end LIBOR?**

   LIBOR – the London Interbank Offered Rate – represents the average interest rate at which banks reasonably expect they can borrow money from each other. Established in the 1980s, the rate was intended to create a uniform benchmark that all banks could reference. Today, several banks and other financial institutions cite LIBOR when establishing interest rates, and it is estimated that $350 trillion of loans and other financial products have LIBOR-based interest rates. Recently, the integrity of the rate and the process came into question during the height of the financial crisis, when several leading banks faced allegations of manipulating LIBOR by submitting dishonest rates to bolster their bottom lines. The allegations resulted in billions of dollars in fines and settlements against the financial institutions and left serious questions about the future of LIBOR. In July 2017, the chief executive officer of the Financial Conduct Authority, the regulatory agency that oversees LIBOR, called for the end of LIBOR by 2021.

2. **What impact does this have?**

   The call to end LIBOR will have a tremendous effect on financial institutions and customers with outstanding obligations. Many consumer and commercial loans have floating interest rates that are tied to the LIBOR index. Without LIBOR, these loans will need to be repriced using an alternative rate. Some credit agreements call for the use of interest calculations based on a prime rate should LIBOR no longer be available. This would likely result in a significant increase in the cost of the loan to a borrower. The use of LIBOR had become so common place, however, that many credit agreements failed to define a replacement for LIBOR, leaving ambiguities in the loan documents that will likely need to be remedied by loan modifications.

3. **Will something replace LIBOR?**

   In the United States, the Alternative Reference Rate Committee (ARRC) holds responsibility for the transition away from LIBOR and to a new replacement index. The ARRC has proposed the introduction of the Broad Treasury Financing Rate (BTFR), a rate determined through a variety of US treasury market-based transactions. As it is a new index, the BTFR has yet to be published, but the Federal Reserve expects to begin publishing the rate in 2018. Another potential replacement includes a rate based on the actual overnight lending that takes place among major banks.

4. **What should lenders and borrowers consider?**

   Lenders and borrowers should review existing credit agreements to determine if their loan's interest rate is tied to LIBOR and if there is a defined substitute. If there is no defined substitute, an amendment to the credit agreement may be in both the lender and borrower's best interest to redefine the interest rate and avoid any confusion once LIBOR goes away. As indicated, many credit agreements include provisions that permit a lender to select an alternate source (such as prime) to calculate the interest rate in the event that LIBOR is unavailable; regardless of whether an alternative source is suggested, lenders and borrowers should discuss what alternate source the lender intends to use and at what point the interest rate will be calculated using the alternate source.

   In negotiating future credit agreements, lenders and borrowers should be conscious of the call to end LIBOR, including considering alternate indexes when setting interest rates for future transactions. If a LIBOR-based rate is used, lenders and borrowers should ensure a provision is included providing for an alternative index if and when LIBOR is gone.

If you have any questions regarding LIBOR or the impending end of the benchmark, please contact one of the McDonald Hopkins attorneys listed below.

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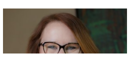

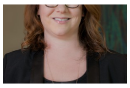

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