LEGAL UPDATES

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Alternative Reference Rates Committee (ARRC) Circulates Proposed LIBOR Transition Provisions

The proposed LIBOR transition provisions, among other things, identify LIBOR transition triggers and establish a waterfall of replacement benchmark rates, starting with the Secured Overnight Financing Rate.

Secured Overnight Financing Rate (SOFR)

The ARRC recommended SOFR as the LIBOR replacement benchmark rate. SOFR measures the cost of overnight cash borrowing secured by U.S. Treasury securities. It is intended to be a nearly risk-free rate and therefore is likely to be lower than LIBOR.

There have been many recent developments laying the groundwork for SOFR to become the new reference rate. In April 2018, the Federal Reserve Bank of New York began publishing SOFR. In May 2018, CME Group launched one-month and three-month SOFR futures, and in July 2018, CME Group began clearing with LCH (clearing house) SOFR overnight index swaps and basis swaps. CME Group has announced that in the third quarter of 2018 it will clear SOFR swaps. In July 2018 and August 2018, several debt issuances were tied to SOFR, including a $100 million six-month certificate of deposit issued by Credit Suisse.

The Triggers

The proposed LIBOR transition provisions define triggers that will cause LIBOR to transition to a new benchmark rate. Although the ARRC has proposed SOFR as the replacement reference rate, the language reflects the understanding that SOFR may not always be the replacement reference rate and therefore references, generically, a benchmark rate.

Each trigger is defined as a "Benchmark Discontinuance Event." The triggers include:

A public statement by the administrator of a benchmark rate that the administrator has ceased, or will cease, to provide such benchmark rate.

A public statement by the regulatory supervisor for an administrator of a benchmark rate, by the applicable central bank or by certain other governmental, quasi-governmental and judicial entities with appropriate jurisdiction, to the effect that the administrator for such benchmark rate has ceased, or will cease, to provide such benchmark rate.

The administrator of a benchmark rate fails to publish such benchmark rate for five consecutive days (with certain exceptions).

A public statement by the administrator of a benchmark rate that it has insufficient submissions in connection with calculating such benchmark rate.

A public statement by the administrator of a benchmark rate that such benchmark may no longer be used or is of such low quality that using such benchmark rate would have a significant negative impact on its liquidity.

Waterfall of Replacement Benchmark Rates

The ARRC establishes a waterfall of replacement benchmark rates in the following order of priority:

SOFR for a specified future term plus spread.

Compounded average daily SOFR over a specified period (may be calculated in advance or in arrears) plus spread.

SOFR as of a date certain plus spread.

Replacement reference rate (other than SOFR) recommended by the applicable governmental entity plus spread.

Replacement rate as defined in swap contracts at such time plus spread.

Replacement rate determined by the parties plus spread.

What This Means to You

LIBOR may not exist beyond 2021. Much work is being done to effect the transition from LIBOR to a new benchmark rate. Every party to a credit facility in which interest is calculated by reference to LIBOR will be impacted by the transition from LIBOR to SOFR (or another reference rate). As we get close to phasing out LIBOR, developments will likely accelerate. Staying current with LIBOR transition developments will better position your organization for the eventual cessation of LIBOR.

Contact Us

For more information about the transition from LIBOR to SOFR and the proposed LIBOR transition language, please contact William D. Gardner or another member of Husch Blackwell's Banking & Finance team.