Ready or Not, It's Time to Plan for the Inevitable End of Libor

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Those who haven't addressed the discontinuation of Libor and the transition to a new rate had better do so sooner, not later. That was the message of the three ABS East panels dedicated to the subject on Sept. 22, the first day of the conference. Libor, a key benchmark interest rate, is scheduled to be phased out by the end of 2021, putting trillions of global currency that are tied to the rate at risk.

The U.S. Federal Reserve and the New York Fed together formed an Alternative Reference Rates Committee to identify an alternative benchmark rate for the United States. The first panel focused on ARRC's recommended rate, the Secured Overnight Financing Rate, which is based on overnight repurchase agreements backed by U.S. Treasuries. There are five different applications of SOFR being considered: daily SOFR, the most volatile; forward-looking term SOFR, which the polled audience favored but it doesn't yet exist; SOFR compounded in advance; SOFR compounded in arrears; and simple SOFR in arrears.

The second panel heavily focused on "fallback language" in transaction documents. Jeanne Naughton-Carr, who is a managing director and associate general counsel at BNY Mellon, emphasized that the fallback language must be clear about what the benchmark being unavailable means and what the replacement should be. Any previous fallback language that existed in documents mainly addressed a temporary cessation of Libor, not a complete termination. The hope in being specific is to facilitate the expected and any future transitions. ARRC published guidelines for fallback language as well as acceptable modifications that industry participants may use.

So far since April 2018, SOFR has been lower than Libor, so accurately determining the spread between the two is another hurdle the industry will have to jump. The third panel discussed the operational and technological difficulties of incorporating SOFR, especially regarding calculating the spread adjustment. Nitish Idnani, an advisory principal at Deloitte & Touche, was optimistic that eventually the industry's questions and concerns will be sorted out. However, "don't underestimate the amount of testing that will need to happen," he warned.

All three panels had the same underlying message. With the end of Libor in sight, market participants need to prepare themselves so they can make an orderly transition to SOFR or to whatever key benchmark is next.

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