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LIBOR Cessation: The Next Frontier

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By John J. Osinski

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It's never too early to get ahead of the curve on the LIBOR transition front. While lenders may have just cleared the first hurdle in the process - ensuring no new LIBOR contracts moving forward - questions still remain about what comes next. Many banks are asking, "What happens now when we amend an existing LIBOR contract? Given that we've passed December 31, 2021, do we need to replace LIBOR as part of the amendment?"

The short answer is that it depends on whether the amendment is considered a "new LIBOR contract" under the guidance issued by the U.S. federal banking regulators (prudential regulators). In late 2020, the prudential regulators advised that entering into new contracts that use USD LIBOR as a reference rate after December 31, 2021 would create safety and soundness risks – and that they would examine bank practices accordingly. The prudential regulators further clarified, in an October 2021 statement, what constitutes a "new LIBOR contract" for these purposes, stating that a new LIBOR contract would include "an agreement that (i) creates additional LIBOR exposure for a supervised institution or (ii) extends the term of an existing LIBOR contract." Then, by negative implication, an amendment that does not increase exposure and does not extend term should not constitute a "new LIBOR contract" for purposes of this guidance.

As such, an amendment to an existing LIBOR contract that does not increase the commitment or extend the maturity date would not be required to be amended at that time to also replace the LIBOR rate. That said, should a bank simply leave the LIBOR rate in place under these circumstances? For other reasons, that may not be the best course of action.

As discussed above, if a bank is amending an existing LIBOR contract for any reason other than to increase the commitment, add new LIBOR exposure, or extend the maturity date (for example, amending to modify a financial covenant), the prudential regulator's guidance may

not require that the contract also be amended to move the loan from LIBOR to SOFR (or another rate), but that reprieve is short-lived. By not addressing the existing LIBOR rate at the time of amendment, a bank is buying itself seventeen months at most. That's because the next frontier on the LIBOR horizon is looming near – June 30, 2023 – which, right now, is the date that USD LIBOR will cease completely.

Looking ahead, in those instances where an existing LIBOR loan that matures after June 30, 2023 is otherwise being amended, the bank should consider moving it to an alternate rate as part of that amendment; otherwise, the bank is just kicking the can down the (relatively short) road. Banks are already thinking about how best to reduce their pools of LIBOR loans that need to be remediated by June 30, 2023, and establishing processes, policies and procedures for moving loans away from LIBOR as part of routine amendments is one effective way to start reducing that pool.