Originally published on Law360.com

# Financial Institutions Seem Unprepared For Libor Demise

By **Kevin Trabaris** (May 14, 2018, 1:23 PM EDT)

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Since the 1980s, U.S. debt markets have been increasingly reliant on the use of the London Interbank Offered Rate for setting short-term rates in U.S. dollar-denominated loans and related instruments. But in 2012, after a series of criminal and civil actions, it became evident that Libor would need to be replaced with a new index. Then came the announcement that Libor would be phased out by Dec. 31, 2021, which was no surprise. In a report published on March 5, 2018, the Alternative Reference Rates Committee of the New York Federal Reserve Bank estimated that the size of debt applying U.S. dollar Libor is around $200 trillion.

Recently the New York Federal Reserve announced that it would begin publishing the Secured Overnight Financing Rate, or SOFR, as a new index to replace Libor in U.S. dollar instruments. SOFR has since been gathering steam as a strong contender for a new short-term index, but time is needed to observe how SOFR performs over a longer period of time.

The fact that Libor is to be eliminated has been a certainty known by businesspeople and attorneys working in the financial service market for a while. An interesting question is how far banks and other Libor-reliant financial institutions have prepared for its demise.

My firm, Culhane Meadows PLLC, polled some of its financial clients to determine the state of their activity in preparing for the end of Libor. The survey was conducted in March 2018 and the results have been compiled.

The results of the survey show some interesting patterns. A full 80 percent of the respondents indicated that they are aware that Libor will be phased out by Dec. 31, 2021. This result demonstrates the widespread understanding of the issue that the firm expected to see. The Libor scandal was an important issue in the financial services market and was closely followed within the industry. The percentage dropped to slightly over 60 percent when the survey polled clients on whether they are aware of activity within their company to prepare for the change in indexes, and 15.79 percent reported that they were unsure whether such activity is occurring.

The survey followed up with those who responded that they were aware of activity to prepare for the change. Two-thirds of the respondents indicated that their company is preparing a plan for Libor's replacement and half of those who responded stated that they have been notified internally to start preparations for the move from Libor. This response reflects the widespread awareness of the issue. It does not, however, indicate anything is actually being done to remedy the issue. A much smaller percentage of respondents, around 30 percent, indicated that their institution is reviewing existing debt instruments that contain Libor as a rate option.

In our experience, language is being added to Libor definitions to address the uncertainty of its future to amendments and new facilities. Few clients of Culhane Meadows, if any, have asked attorneys to amend existing debt facilities solely for the purpose of addressing Libor’s demise or to replace Libor with another index. A small percentage of respondents to the survey, 8.33 percent, indicated that they are aware of an internal timeline related to the Libor issue. No clients responded positively to the survey option that their institution is phasing out offering Libor or phasing out booking new loans with Libor. This conforms with the firm’s experience of clients continuing to do new deals with Libor as an index.

With respect to those persons who indicated they were not aware of any Libor-related activities within their institution, two-thirds indicated that their company had not yet progressed from internal discussions to action items. Half of the respondents replied positively to the question that their firms are waiting for a consensus to form over a replacement rate for Libor. We received no positive responses to the questions that asked if they felt it is too soon to act, if they plan to address the issue in 2021, or if competitive pressures for the use of Libor have delayed action. The number of respondents to this question were few, so the survey results may have been skewed by the lack of responses.

The last question asked was whether they are aware that the Secured Overnight Financing Rate has been selected to replace U.S. dollar Libor. The question may have overstated the certainty that institutions will adopt SOFR but not the intention of the New York Fed to have this index be Libor’s replacement. It should also be noted that the survey was sent a few weeks prior to the start of SOFR’s publication. Having said that, the results to the question were surprising. Over 80 percent of the respondents opted for an answer of “no.” This means that there is a steep learning curve for financial institutions to overcome before there will be widespread understanding of SOFR and its use. When compared to the overwhelming response among clients that they are aware of the Libor issue, it may seem surprising to find such a lack of knowledge about SOFR. However, after considering the lack of respondents who stated that they are aware of their company phasing out offering Libor or phasing out booking new loans with Libor, it becomes clearer. Until financial institutions start acting on replacing Libor, SOFR may languish in the minds of people who continue to book Libor deals.

Many attorneys have advised clients to replace Libor debt before the end of 2021. It is generally considered safer for parties to a debt instrument to agree to a new index to replace Libor rather than to rely on the usually vague language stating that at such time that Libor is no longer available, the lender will apply a similar index of its choosing. We would argue that the time to prepare a plan for the Libor issue is now; this includes assessing the amount of an institution’s exposure, evaluating whether Libor language should be amended now on deals maturing after 2021(or earlier), and addressing the technology hurdles with applying a new rate.

While at present, competitive pressures cause Libor to be employed in new deals, institutions should watch the published SOFR rates, and other possible substitutes, to determine what index best suits their business needs and market requirements.

Why act now? It would not be surprising to assume that the class action bar is anxiously awaiting the results of the transition process.

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