BENEFIT STREET PARTNERS

A Franklin Templeton Company

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Update - LIBOR is Ending: Get Ready

Key Takeaways

- While the majority of LIBOR is scheduled to phase out by the end of 2021, overnight, 1-, 3-, 6- and 12-month USD LIBOR will remain in effect through June 30, 2023
- While US officials continue to favor SOFR as the successor rate to LIBOR, there are concerns around the implications of not using a term rate
- Regulatory authorities and industry organizations have advised that new credit agreements should no longer reference USD LIBOR as of December 31, 2021
- Benefit Street Partners believes yields in existing credits will not be negatively impacted by the change

On March 5, 2021, the ICE Benchmark Administration (IBA), the authorized and regulated administrator of LIBOR, announced that it would cease publication of USD LIBOR on December 31, 2021 for 1-week and 2-month LIBOR and on June 30, 2023 for all other tenors[1]. A majority of the panel banks, which are responsible for providing their funding rates to calculate LIBOR, have stated that they will no longer provide the required information following these dates. However, the UK Financial Conduct Authority (FCA) has the power to require the IBA to continue to publish LIBOR settings on a synthetic basis[2]. Unless the FCA steps in, existing US credit agreements, which typically use 1-month or 3-month LIBOR as the reference rate, will be impacted in June of 2023.

To assist with the transition, regulatory authorities and industry organizations have advised that new contracts cease using USD LIBOR as a reference rate as soon as practicable, but no later than December 31, 2021[3]. The Alternative Reference Rates Committee (ARRC) has provided LIBOR fallback language and Benefit Street Partners has been including the recommended language in credit agreements where possible.

The ARRC fallback language recommends that the existing benchmark be replaced with the successor rate plus a spread adjustment[4]. In conjunction with the end of LIBOR, the International Swaps and Derivatives Association, Inc. (ISDA) announced spread adjustments to the secured overnight financing rate (SOFR) as detailed in exhibit 1 below[5]. For the majority of cash products, the ARRC has recommended a spread adjustment that is in line with that of ISDA[6]. Benefit Street Partners believes yields in existing credits will not be negatively impacted by the change.

Exhibit 1: 1-Month and 3-Month USD LIBOR/SOFR Spread Adjustments[5]

LIBOR	Tenor	Ticker	Spread Adjustment (%)
USD	1-Month	SUS0001M Index	0.11448
USD	3-Month	SUS0003M Index	0.26161

While US officials continue to favor SOFR as the successor rate to LIBOR, there are concerns around the implications of not using a term rate. Unlike LIBOR, SOFR rates are only produced based on actual overnight maturity. Last week the CME Group announced they would produce CME term SOFR (with forward looking 1-, 3- and 6-month tenors) which could alleviate some of the industry's outstanding concerns with respect to SOFR.[7] While this announcement is a step in the right direction, the market will continue to evaluate long term implications of this proposal.

Footnotes

[1] Source: ICE LIBOR® Feedback Statement on Consultation on Potential Cessation, March 2021, https://www.theice.com/publicdocs/ICE_LIBOR_feedback_statement_on_consultation_on_potential_cessation.pdf

[2] Source: FCA announcement on future cessation and loss of representativeness of the LIBOR Benchmarks, March 2021. https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf

[3] Source: ICE LIBOR® Feedback Statement on Consultation on Potential Cessation, March 2021, https://www.theice.com/publicdocs/ICE_LIBOR_feedback_statement_on_consultation_on_potential_cessation.pdf

[4] Source: ARRC-Updated-Final-Recommended -Language-June –30-2020

[5] Source: Bloomberg. https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf

[6] Source: Alternative Reference Rates Committee, March 2021, https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Benchmark_Transition_Event_FAQs.pdf

[7] Source: CME Group Announces Launch of CME Term SOFR Reference Rates, April 2021, https://www.cmegroup.com/media-room/press-releases/2021/4/21/cme_group_announceslaunchofcmetermsofrreferencerates.html