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<u>Are You Prepared? Major Changes Ahead in 2021 with LIBOR Elimination</u>

The London Interbank Offered Rate (LIBOR), the dominant benchmark interest rate for the majority of adjustable rate credit products and derivatives, is scheduled to be phased out by the end of 2021.[1] Currently, LIBOR is estimated to be the basis of more than $300 trillion dollars in outstanding adjustable rate loans. Experts estimate that more than $200 trillion dollars stem solely from LIBOR based adjustable rate mortgages and other credit derivatives.[2] Community banks in particular, use these products daily, and could be critically impacted by LIBOR's elimination. Accordingly, it is incumbent on community banks to begin to prepare for the elimination of LIBOR now.

LIBOR has a complicated history and, in recent years, has drawn scrutiny from regulators as an unstable rate, easily influenced by savvy financial experts.[3] These concerns of LIBOR's unpredictability and undue influence originate from LIBOR's subjective calculation. LIBOR is calculated by simply estimating how much interest financial industry leaders *would pay* to borrow money on a short-term basis from other institutions.[4] Regulators argue that basing a rate on what leaders *would pay* is arbitrary and creates an inherent vulnerability in the rate.

Some industry leaders have been reluctant to heed the warning that, come 2021, LIBOR is phasing out. Regardless, LIBOR is going away. Recently, Andrew Bailey, the Chief Officer of the United Kingdom Financial Conduct Authority (FCA), which administers LIBOR, remarked that, "the discontinuation of LIBOR should not be considered a remote probability." [5] As we edge closer to 2021, the financial industry is now examining the various proposals which would replace LIBOR, and question how a bank with a large portfolio of LIBOR based credit products can best prepare for its impending demise.

The general consensus among regulators is that banks should be migrating toward another rate benchmark: The Secured Overnight Financing Rate (SOFR). Regulators applaud SOFR because it is a purely transaction-based rate benchmark. Put simply, unlike LIBOR—which objectively examines what industry leaders *would pay* to borrow money on a short-term basis, SOFR calculates the previous day's transactions and measures precisely what financial industry leaders *are paying* to borrow money on a

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[1] Andrew Bailey, Chief Exec. of FCA, Address at Bloomberg London: *The future of LIBOR* (July, 7 2017), https://www.fca.org.uk/news/speeches/the-future-of-libor
[2] Matt Phillips, *The Most Important Number in Finance Is Going Away. Wall St. Isn't Prepared*, N.Y. Times (July 19, 2018), http://www.nytimes.com/2018/07/19/business/libor-future-2021-phase-out.html
[3] John Heltman, *Libor is going dark in 2021, and some banks aren't ready*, American Banker, (Dec. 30, 2018), http://www.americanbanker.com/news/libor-is-going-dark-in-2021-and-some-banks-arent-ready.html
[4] Michael J. De La Merced, *Understanding LIBOR*, N.Y. Times (July 7, 2012), http://www.dealbook.nytimes.com/2012/07/10/q-and-a-understanding-libor.html
[5] *Id.; see fn. 2*

short-term basis from other financial instructions.[6] Regulators argue SOFR will breed more predictability and lessen risk. There are also some additional benchmarks, such as the Federal Reserve's fed funds rate.

Irrespective of SOFR's virtues, the reality is that 2021 is quickly approaching. Transitioning your bank's current and future portfolios (as well as computer systems) to a new rate benchmark will, no doubt, prove to be a taxing overhaul and it is imperative that preparation for your organization begins now. Recognizing this gravity, regulators addressed this topic last month at the Federal Reserve's Board of Governors meeting, and outlined potential economic, reputational, legal, operational and regulatory issues banks are likely to face during their transition from LIBOR to SOFR. Whatever you decide to do, it is important to start looking at documents now and determine how they might need to be adjusted. For example, if your bank issues a loan with a LIBOR rate structure, include some language in the loan documents that allows you to designate an alternative index at any time in your sole discretion.

Should your bank want to discuss potential strategies or available options, please contact Dan Brannan at (404) 997-6023 (dbrannan@jamesbatesllp.com), Michael White at (478) 749-9921 (mwhite@jamesbatesllp.com), or Corrie Hall at (478) 749-9949 (chall@jamesbatesllp.com).

[6] Bruce Klein, *Goodbye LIBOR, Hello SOFR*, Forbes (Apr. 19, 2018), http://www.forbes.com/sites/forbesnycouncil/2018/04/19/goobye-libor-hello-sofr/#4b4f0615717d.html