LIBOR-Related Provisions: What Borrowers Should Know Now

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The market has been awash with talk of the London Interbank Offered Rate (LIBOR)'s obsolescence since the Financial Stability Board's July 2014 report recommending reforms to LIBOR.[1] On March 5, 2021, the Intercontinental Exchange and the Financial Conduct Authority confirmed that LIBOR will, in some cases, cease on December 31, 2021, and for others, on June 30, 2023.[2] Phillips Lytle sifted through the noise and has identified important provisions to look for in existing loan documents or in loan documents a business may negotiate in the coming months.


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Many lenders, especially at larger financial institutions, have adopted the "hardwired" approach to the LIBOR replacement. This means that these lenders will include specific language in their loan documents setting forth a new reference rate to replace LIBOR and a trigger for when the replacement reference rate kicks in, as well as other elements such as interest rate floors or details about the spread. Both borrowers and lenders find the hardwired approach attractive because it provides the parties with some certainty in advance of the LIBOR transition, but as its name would suggest, the "hardwired" approach does not offer either party much flexibility.

Conversely, some lenders have included provisions in their loan documents that allow them to implement a replacement reference rate at their discretion. In some cases, the replacement reference rate is solely discretionary — meaning the lender can use *any* reference rate. The discretionary approach provides flexibility to lenders, especially to smaller institutions that may find it too risky to adopt a hard replacement so far in advance, but may leave borrowers in the dark for some time.

Borrowers, do not drag your heels when the transition of LIBOR goes into effect. Now is the time to review your loan documents and talk to your lender about their approach to the transition of LIBOR.

If either the replacement rate or transition timing (or trigger) are missing or unclear in the loan documents, the borrower should reach out to their lender for further clarification. By now, most lenders have adopted more formal LIBOR replacement policies and can walk the borrower through the terms of its hardwired approach. Borrowers should confirm whether any floors apply, if the spread is susceptible to change (and how), and what happens if the anticipated replacement rate proves to be unavailable when the trigger event occurs. A borrower that is entering into a new loan should ensure that the elements listed are clear. LIBOR replacement provisions can be lengthy, so borrowers should take the time to work through the new formulation, including any potential interest rate floors.

Additionally, borrowers should monitor the hardwired formulation periodically to ensure that the potential replacement reference rate is not substantially to their disadvantage. They should keep in mind that LIBOR rates and replacement reference rates may have changed significantly since a loan was originated. If the replacement reference rate looks to be detrimental, discuss the situation now — waiting can be costly, both in terms of a potentially unanticipated higher rate or due to any breakage costs that might arise if borrowers want to transition away from the replacement reference rate (via refinancing or otherwise). For example, a sudden transition of LIBOR to a prime rate plus the negotiated spread can be a costly shock.

Lenders using the discretionary approach are likely to want to maintain robust discretion over the LIBOR replacement. However, some flexibility is available in the market. Borrowers negotiating new loan documents should at least push for language requiring the lender to implement the replacement reference rate that would approximate their current applicable rate (LIBOR plus the negotiated spread).

Borrowers with existing discretionary language should check with their lender periodically about potential reference rates. If the only fallback reference rate is the lender's prime rate, a borrower can consider requesting an amendment to a more favorable arrangement.

Finally, businesses should review legacy documents that have been amended and extended over time without updates to the reference rate provisions. In such cases, the only available replacement reference rate in the loan documents may be the lender's prime rate, which would put the borrower at risk of costly increases.

For most borrowers, the transition of LIBOR will not result in dire or dramatic impacts. However, now is the time to start working with your lender to resolve any questions or uncertainty about how the transition of LIBOR will be handled or to request corrective or clarifying modifications.

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[1] *Financial benchmarks,* Financial Stability Board (FSB) (June 7, 2021), https://www.fsb.org/work-of-the-fsb/market-and-institutional-resilience/financial-benchmarks/.

[2] *LIBOR Transition FAQs - UPDATED March 2021,* JD Supra (June 7, 2021), https://www.jdsupra.com/legalnews/libor-transition-faqs-updated-march-2021-6636975/#:~:text=On%20March%205%2C%202021%2C%20ICE,being%20published%20December%2031%2C%202021.