LIBOR Foundational Knowledge

The reshaping of the financial markets to replace USD LIBOR (The U.S. dollar London Interbank Offered Rate) as the primary benchmark interest rate with an alternative rate is no small undertaking. That transition is underway, with UK and US regulatory agencies advising banks to cease new LIBOR-based lending as soon as practical, but no later than December 31, 2021.

The Alternative Reference Rates Committee (ARRC) – a group of private- market participants convened by the Federal Reserve to address LIBOR transition –identified the Secured Overnight Financing Rate (SOFR) as the recommended replacement for USD LIBOR. This promises to be a significant change for all market participants and is likely to evoke questions from our commercial borrowers. Listed below are a few excerpts from a document prepared and published by the ARRC.

Why does the market need a new benchmark interest rate?

Since the financial crisis, banks have moved away from unsecured, wholesale borrowings. As a result, LIBOR is increasingly based on the expert judgment of panel banks, and therefore an increasingly less robust, transactions-based market interest rate.

What is the recommended alternative for USD LIBOR and what other rates were considered?

On June 22, 2017, the ARRC identified the Secured Overnight Financing Rate (SOFR), as its recommended alternative to USD LIBOR.

What is SOFR and why is it more robust than LIBOR?

SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities and is published by the Federal Reserve Bank of New York. For additional detail, click to view all of the "Frequently Asked Questions" published by the ARRC. These discuss the creation of the ARRC, the reasons for choosing SOFR as the recommended replacement for LIBOR, and some of the ways that SOFR is expected to impact the market.

In addition to loan interest rates, ISDA ("International Securities Dealers Association") selected SOFR as the replacement rate for LIBOR swaps in the derivatives market. This will result in increased SOFR capacity in the futures market to support the cash market for financial institutions.

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