M&T Bank

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LIBOR: Foundational Knowledge

The transition away from USD LIBOR (The U.S. dollar London Interbank Offered Rate) as the primary benchmark rate for commercial loans is underway, with UK and US regulatory agencies anticipating that USD LIBOR will not be available after December 31, 2021. The Federal Reserve-sponsored Alternative Reference Rates Committee (ARRC) – a group of private-market participants convened to address LIBOR transition – has 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 you, our commercial borrower. 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?
LIBOR is increasingly based on the expert judgment of panel banks due to the declining amount of unsecured, wholesale borrowings by banks since the financial crisis. For this reason, LIBOR is increasingly less of a 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"[1] 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") has selected SOFR as the replacement rate for LIBOR swaps in the derivatives market. This will result in the build out of SOFR capacity in the futures market to support the cash market for financial institutions. Future communications in this series will specifically address the impact of LIBOR transition on hedged loans.