COVID-19’s impact on the LIBOR transition

James E. Stief, Jason M. Smith, Jake J. Weinberg | Wednesday, March 18, 2020

LIBOR – the London Interbank Offered Rate – represents the average interest rate at which major banks reasonably expect they can borrow money from each other without putting up collateral. In July 2017, Andrew Bailey, Chief Executive of the Financial Conduct Authority (FCA), the entity which oversees LIBOR in the U.K., announced that it will no longer encourage or compel banks to report LIBOR after 2021. In the U.S., the Federal Reserve endorsed the Secured Overnight Financing Rate (SOFR) as the preferred alternative benchmark for LIBOR.

With only 21 months left until the 2021 deadline to transition away from LIBOR, how does COVID-19 impact LIBOR transition plans?

Since banks will be busy dealing with COVID-19, each bank’s LIBOR transition plan could potentially take a backseat in the short term. Since COVID-19 appears to be a once-in-a-lifetime event, longer-term initiatives such as LIBOR transition plans could get deprioritized so that banks can focus on the challenges of trying to stay operational during these challenging times.

On March 2, 2020, the Federal Reserve began publishing 30-, 90- and 180-day SOFR averages and a SOFR index. According to the Federal Reserve, the SOFR averages and index use daily compounding on business days and a simple interest at a rate of interest equal to the SOFR value of the preceding business day on non-business days. SOFR averages are published as percentages rounded to the fifth decimal place and the SOFR index measures the cumulative impact of compounding SOFR on a unit of investment over time, with the initial value set to 1.00000 on April 2, 2018 (the first value date for SOFR).

While many experts believe that SOFR is supposed to be superior to LIBOR in certain respects, there are concerns about how SOFR could behave during periods of economic stress. SOFR is a backward-looking rate, whereas LIBOR is a forward-looking rate. With the COVID-19 pandemic poised to have a huge impact on the economy, it will be interesting to monitor the differences in the LIBOR rate and SOFR rate over the coming months and to see if experts find a need to adapt SOFR to handle disruptive economic events like COVID-19. We will continue to monitor COVID-19s impact on the LIBOR transition and provide updates as they occur.

James E. Stief

Team member bio

Jason M. Smith

Team member bio

Jake J. Weinberg

Team member bio