Alert

February 25, 2020

COZEN O'CONNOR

Transitioning for the End of LIBOR

In July 2017, Andrew Bailey, chief executive of the UK Financial Conduct Authority (FCA), announced that by the end of 2021, the FCA would no longer seek to compel or persuade panel banks to submit quotes for LIBOR.

LIBOR, or The London Interbank Offered Rate, is a benchmark rate at which major global banks lend to one another in the international interbank market for short-term loans. This rate is widely used as a reference rate for many financial instruments, including those in the United States. Due to the financial crisis in 2008 and rate manipulation by various financial institutions in 2012, LIBOR is no longer viewed as a trustworthy reference rate and is expected to be discontinued by the end of 2021.

The discontinuation of LIBOR will undoubtedly have a significant impact on the financial markets and on accounting and financial reporting requirements. But the biggest impact will be on financial instruments that reference LIBOR.

With the nearly $300 trillion worth of financial instruments that rely on LIBOR, clients should assess the impact that the discontinuance of this rate will have on their businesses. Clients should begin by identifying the various instruments that reference LIBOR, such as debt instruments, bank loans, and certain securities, and determine the impact that the discontinuance of LIBOR will have on each such financial instrument. Importantly, clients should identify whether the financial instruments contain provisions for alternative reference rates should LIBOR no longer be quoted. However, even if such a provision exists, it will likely be inadequate, particularly from a borrower's perspective, since such alternative rates are generally higher than LIBOR. For example, the current spread between the prime lending rate as published by The Wall Street Journal and One-Month LIBOR is approximately 300 basis points.

In addition, the shift from LIBOR to a new or alternative rate can result in tax consequences to the lender, borrower, or both. The lender may be viewed as exchanging its current debt instrument for another newly issued instrument, potentially triggering gain or loss to the lender. A borrower, on the other hand, could potentially realize cancellation of indebtedness income as a result of the change in interest rates. Moreover, the shift in rates may result in original issue discount, creating interest income for the lender and expense for the borrower. The IRS, however, has already issued guidance to address commonly anticipated issues arising in connection with the transition from LIBOR, and this guidance can help taxpayers to prevent adverse tax consequences.

Accordingly, as a next step, clients should understand the various alternative rates that exist and select the appropriate reference rate, taking into account the impact such reference rate will have on its financial instruments and ultimately profitability, as well as any resulting tax considerations. As part of this process, clients should engage with their instrument counterparties to develop a plan to transition away from LIBOR and amend existing financial instruments to implement the agreed upon alternative rate or include fallback provisions if an acceptable alternative rate has not yet materialized. Additionally, clients should stay current on market developments to see if a new rate becomes accepted as a benchmark reference rate.

If you should have any questions concerning this article, please contact either Benjamin A. Bomrind or Anne M. Madonia of the firm's Corporate Practice Group and Joshua C. Weinberger of the firm's Tax Group.

Benjamin A. Bomrind

Co-Chair, Commercial Finance

bbomrind@cozen.com
Phone: (212) 883-4957
Fax: (212) 509-9492

Anne M. Madonia

Member

amadonia@cozen.com
Phone: (215) 665-7259
Fax: (215) 665-2013

Joshua C. Weinberger

Member

jweinberger@cozen.com
Phone: (215) 665-2173
Fax: 866-248-2899

Related Practice Areas

- Business
- Corporate Governance
- Private Equity
- Real Estate