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Overnight LIBOR and SOFR Performance During the COVID-19 Crisis

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As financial market participants are aware, the London Interbank Offered Rate ("LIBOR") is not likely to continue after Dec. 31, 2021, for the currencies and maturities for which it is currently calculated and reported. Even if it does continue after that date, it is likely that it will not be representative of the same rate because in July 2017, the United Kingdom's Financial Conduct Authority ("FCA") announced its intention not to sustain LIBOR after the end of 2021.

For market participants expecting or supporting a delay in the implementation of this change, in particular in light of the effects of the global pandemic resulting from COVID-19, as of the date of this writing there has been no statement to that effect from the FCA or from LIBOR's administrator. Therefore, as of this date, it is still expected that the panel banks which submit information for the calculation of LIBOR interest rates will not be compelled to do so after 2021. Market participants should continue preparing for the discontinuation of LIBOR to occur by the end of 2021, unless and until the FCA indicates otherwise.

In the United States, the Alternative Reference Rates Committee ("ARRC") of the Federal Reserve has proposed the Secured Overnight Financing Rate ("SOFR") as a replacement for U.S. dollar LIBOR as a reference rate in financial contracts. For contracts transitioning from LIBOR to SOFR, the ARRC proposes that a reference rate modifier be used to align the SOFR based replacement reference rate more closely with the LIBOR based reference rate. The New York Federal Reserve ("NY Fed") has been publishing overnight SOFR rates since April 2018. In March

2020, the NY Fed began publishing compounded averages of SOFR over rolling 30-day, 90-day and 180-day periods ("SOFR Averages").

The table attached includes a comparison of overnight U.S. dollar LIBOR, an unsecured rate, and SOFR, a secured rate, from the beginning of March 2020 to April 17, 2020, which includes the period in late March prior to legislative and other regulatory efforts to address the financial effects of the COVID-19 health crisis. Although LIBOR is also published for one-month, three-month and six-month periods, and SOFR Averages are now published for rolling 30-day, 90-day and 180-day periods, a side-by-side comparison is an "apples-to-oranges" comparison because the LIBOR rates are forward-looking rates, while the SOFR Averages look back over the relevant time periods.

It is not surprising that during this period, and in particular from March 16 to March 27, overnight SOFR tightened in comparison to overnight LIBOR. The difference in how they performed underscores the need for market participants to be prepared in advance for the transition from LIBOR, in particular if global events in late 2021 or early 2022 (like global events during the first quarter of 2020) do not accommodate a timely and smooth transition. If there is a lesson to be learned from Q1 2020, it is that the time to prepare for significant and material changes, like the LIBOR transition, is sooner rather than later.

Click here to view the table.

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This is a fast-moving topic and the information contained in this Alert is current as of the date it was published.

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