

# Is Your Organization Ready for the LIBOR Sunset?

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### KEY FINDINGS

- IBOR sunset has the potential to create significant financial reporting issues.
- The financial reporting issues related to LIBOR sunset could impact businesses in many different industries.
- Companies should start preparing now for the upcoming IBOR transition.

**ABSTRACT:** *It is expected that InterBank Offered Rates (IBOR) will cease to exist at the end of 2021. IBORs are interest rates constructed by banks based on estimates of borrowing costs between banking institutions. Three examples include LIBOR (London), HIBOR (Hong Kong), and TIBOR (Tokyo). After 2021, banks will no longer be encouraged by bank regulators to make IBOR submissions, thus precipitating the demise of the IBOR. Unfortunately, hundreds of trillions of dollars of loans and derivative instruments are based on IBOR indexes. As a result, many firms will have to amend or replace current loan agreements and hedging documents to account for the change. In this article, the authors provide a brief history of LIBOR. Then the authors consider the accounting impact of IBOR's sunset under current and proposed US accounting standards and international accounting standards. Most important, the authors recommend that firms address the issue in the near future, rather than waiting until the IBOR sunsets at the end of 2021.*

**TOPICS:** *CLOs, CDOs, and other structured credit, legal and regulatory issues for structured finance, financial crises and financial market history\**

In July 2017, the UK's Financial Conduct Authority (FCA) announced that it would no longer require member banks to make London Interbank Bank Offered Rate (LIBOR) submissions after 2021. Interbank Offered Rate (IBOR) is a general term that includes LIBOR (for five currencies), Euro IBOR (EURIBOR), Tokyo IBOR (TIBOR), and several other rates. IBORs are global interest rate indexes that underpin hundreds of trillions of dollars of loans and notional values of derivative contracts. (Note that in this article, we typically use the general term *IBOR*; we use *LIBOR* where specificity is required). The expectation is that IBORs will no longer serve as the basis for interest rate and discount rate computations for businesses around the globe. Although it is possible that banks could continue quoting IBORs after 2021, market observers do not expect that to happen. Several index rates are expected to replace IBOR. In the US, the Federal Reserve selected the Secured Overnight Financing Rate (SOFR) as an

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alternative to LIBOR. In the UK, industry groups and regulators have recommended the Sterling Overnight Interbank Average Rate (SONIA). For Switzerland, it is Swiss Average Rate Overnight (SARON). The industry expects replacement indexes for other IBORs too. During an industry group presentation, the Federal Reserve's Michael Held referred to the IBOR transition as one of the leading fixed-income market developments (Held 2019).

Businesses around the globe have been attempting to determine the impact of the IBOR transitions to alternate, nearly risk-free reference rates. The issue is pervasive, as businesses have funding, hedging, or risk management activities that are tied to one or more IBOR indexes. Each business must determine what is going to happen to its contracts once IBOR goes away. That is why LIBOR has been referred to as the world's most important number. Its pervasive use as a reference rate in loan and hedging contracts is why the Alternative Reference Rate Committee (ARRC) in the US stated that the LIBOR transition is a key financial stability risk (Held 2019).

As background, LIBOR originated in 1969 and represents the average interest rate that leading London banks would be charged to borrow from other banking institutions. It came into widespread use in the 1970s as a reference rate for dollar denominated deposits located outside the US. The British Banker's Association officially adopted it in 1986 and asked traders from leading banks to provide daily estimates of the rate that they could borrow from other banking institutions. During the 1980s and 1990s, IBORs became the standard indexes in the derivatives markets. When the notional value of derivatives ballooned in the 2000s, so too did the use of IBORs as reference rates. IBORs now serve as the index that underlies the notional value for hundreds of trillions of dollars of hedging agreements.

When IBORs were first created, it was common for banks to fund themselves using short-term loans from other banking institutions. Thus, IBOR rates were based on numerous transactions in the interbank loan market. However, due to the evolution in the financial markets and regulatory sway, interbank lending transactions have become far less common (de Lachica 2019, 1). The result is that IBOR rates, in recent years, have been based more on estimates than on actual transactions.

This makes the daily setting of the IBOR indexes flawed. It also results in a system that is susceptible to manipulation. That is exactly what occurred during the financial crisis in 2007 and 2008. During the resulting IBOR scandal, regulators discovered that banks were falsely inflating or deflating IBOR rates for profit and/or appearance purposes. It became apparent that a new system was needed. Exhibit 1 provides important dates with respect to the IBOR history and transition. Note that some of the events took place over a period of time, rather than at a specific point in time. For example, LIBOR's widespread use as a reference rate took place over several years or even decades.

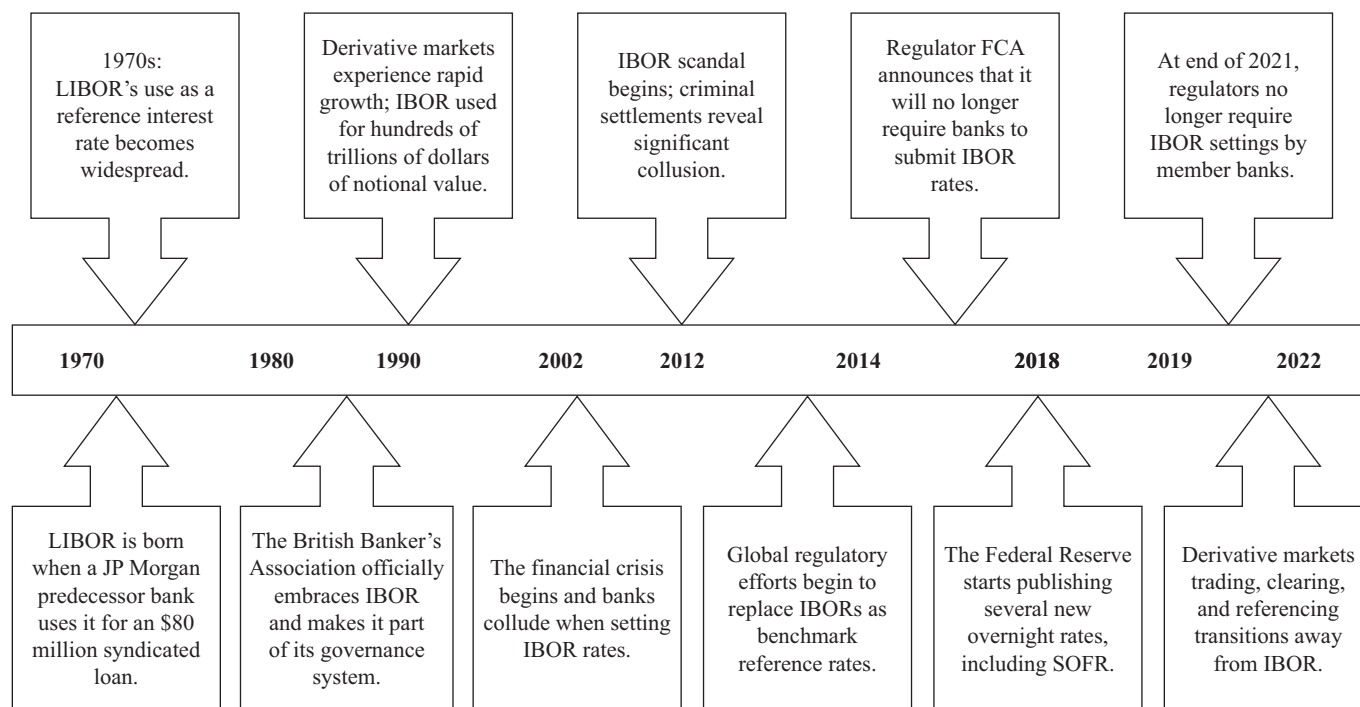
## ACCOUNTING AND FINANCIAL REPORTING IMPACT

The IBOR sunset has the potential to create significant accounting and financial reporting issues for businesses. In its July 12, 2019 *Staff Statement on LIBOR Transition*, the Office of the Chief Accountant of the US Securities and Exchange Commission (SEC) identified four areas: (1) the modification of debt instrument terms, (2) hedge accounting, (3) asset and liability valuation models, and (4) the potential income tax consequences. As expected, the Financial Accounting Standards Board (FASB) in the US and the International Accounting Standards Board (IASB) added projects to their respective agendas to address the accounting issues related to the migration away from IBOR. The following is an overview of the recent developments in accounting guidance in the US and international standards.

In October 2018, the FASB issued Accounting Standards Update No. 2018-16, which added SOFR and the Overnight Index Swap (OIS) rate as benchmark interest rates for hedge accounting. Concurrently, the FASB added to its agenda the consideration of changes to US GAAP related to hedging and financial instruments necessitated by the benchmark rates changes. In its June 19, 2019 meeting, the FASB "tentatively decided that for a contract that meets certain criteria, a change in that contract's reference interest rate would be accounted for as a continuation of that contract rather than the creation of a new contract. This decision applies to loans, debt, leases, and other arrangements" (FASB 2019c). On September 5, 2019, the FASB issued the exposure

## EXHIBIT 1

### Timeline of Prior and Upcoming IBOR Events



draft, *Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting* (FASB 2019b), to ease stakeholder concerns regarding accounting for contract modifications and hedge accounting during the reference rate migration period. The amendments proposed in the exposure draft would apply to contract modifications and hedging relationships through December 31, 2022.

In its June 2018 meeting, the IASB added a research project on IBOR reform to its active research agenda. In May 2019, the IASB published the exposure draft, *Interest Rate Benchmark Reform*, which addresses financial reporting issues in the period before the benchmark rate is replaced. The end date for application, it was noted, is likely to follow different timelines in different markets and jurisdictions (IASB 2019b ¶BC32). This exposure draft provided exceptions to specific forward-looking analysis in hedge accounting requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*, “such that entities would apply those hedge accounting requirements assuming the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are

based is not altered as a result of interest rate benchmark reform” (IASB 2019b ¶BC5). In September 2019, the IASB issued the final amendments (IASB 2019c), *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*, with clarifications to the exposure draft related to *macro hedges*, a group of items designated as a hedged item, and disclosures, in addition to application of the amendments to hedges of both interest rate and foreign currency risks, and providing some relief from the retrospective effectiveness assessment by allowing in some circumstances hedge accounting continuation when hedge ineffectiveness exceeded the 80% to 125% range. (IASB 2019a) As for financial reporting issues after the existing benchmark rates are replaced, the IASB will monitor developments and assess whether any action should be taken as more information becomes available (IASB 2019b).

One of the financial reporting areas where the IBOR sunset is expected to have a significant impact is on commercial and financial contracts, including corporate and municipal bonds and loans, floating rate mortgages, asset-backed securities, consumer loans, interest rate swaps, and other derivatives (SEC 2019).

Contracts with floating rates based on an IBOR index that extend beyond 2021 may trigger contract fallback provisions or require contract renegotiation. Stakeholders expressed concern for the limited time horizon for evaluating a “significant volume of contracts and other arrangements” (FASB 2019b, 1) to determine if the contract modifications precipitated by the IBOR sunset constitute the continuation of existing contracts or the establishment of new contracts. According to current US GAAP, to determine if the modification or renegotiation of a nontroubled debt instrument based on IBOR results in a substantially different debt instrument, the 10% test should be employed. According to this test, modification of a debt contract is deemed to represent an extinguishment of the old debt instrument and the issuance of a new debt instrument “if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument” (FASB 2019a). The difference between the net carrying value of the original debt instrument and the fair value of the new debt instrument is recognized as a gain or loss in income when the modification occurs (FASB 2019a). If the 10% threshold is not reached, the debt instrument is not considered substantially changed. Thus, there is no de-recognition of the debt instrument, the effective interest rate is reset prospectively, and no gains or losses are recognized in income. FASB’s recently issued exposure draft on *Reference Rate Reform* (2019b, Topic 848) provides an Optional Expedient for accounting for modifications of contracts related to receivables (Topic 310), debt (Topic 470), and leases (Topic 842) if the contract modifications relate directly to the reference rate replacement (FASB 2019b). If the contract modifications meet the criteria specified in the topic, “the entity shall account for and present the modified contract as a continuation of the contract existing before the modification for reference rate reform” (FASB 2019b) rather than as a de-recognition or extinguishment of the IBOR-based contract and the creation of a new contract. For debt the 10% test is not applied. For receivables and debt meeting the criteria, the effective interest rate would be prospectively adjusted. Leases meeting the criteria would not be re-measured or reassessed. (FASB 2019b, 2).

Similar to US GAAP, general international reporting guidance indicates that when a *substantial modification* of the terms of an existing financial debt

instrument occurs, it should be accounted for as an extinguishment of the original financial instrument and the creation of a new financial instrument (IASB 2018) normally resulting in gains or losses in current income (IASB 2018). IFRS describes two possible accounting treatments when the modification of contractual cash flows of a financial instrument does not result in de-recognition. According to IFRS 9 paragraph 5.4.3, the gross carrying amount of the financial instrument is recalculated as the present value of the modified contracted cash flows, using the original (IBOR-based) effective interest rate (IASB 2019). The modification gain or loss is recognized in income. Alternatively, the modification may qualify for treatment as a periodic re-estimation of cash flows to reflect the movements in the market rates of interest. This treatment alters the effective interest rate used prospectively, but normally not the carrying amount of the financial instrument materially (IASB 2018, ¶B5.4.5).

A second financial reporting area where the IBOR sunset is expected to have a significant impact is in hedge accounting. Under established accounting guidance, changes in reference rates from IBOR to fallback or renegotiated rates may cause de-designation of the hedging relationships requiring the recording of the borrowing, investment, or derivative at fair value. Initial and subsequent changes in the value of the de-designated hedging instruments are recognized as current period gains or losses resulting in greater income statement volatility. The potential for de-designation of the hedging relationship relies on a number of issues, including changes in the effectiveness of the hedge, and the significance of the rate modification and changes to the hedging documentation.

The effectiveness of the hedge relationships will need to be determined for the alternative rates. Statistical methods and models are commonly used to demonstrate hedge effectiveness both at inception and on an ongoing basis. Some of the IBOR replacements, including SOFR do not have a rich historical database for use in demonstrating the prospective effectiveness of a hedge relationship. As a result, new pricing models may be needed.

Although it is expected that the IBOR replacement will be broadly equivalent, it is possible that under the replacement benchmark rate hedge accounting requirements might not be met. Both FASB and IASB provide some relief to the de-designation of hedging

relationships during the reference rate migration. FASB's Exposure Draft (2019b) on *Reference Rate Reform* (Topic 848) provides an Optional Expedient to the pre-existing requirements related to changes in the critical terms of a hedging relationship that may be applied if the reference rate of the hedging instrument or the hedged item or the hedged forecasted transaction is a discontinued IBOR rate. According to the Exposure Draft, certain changes, in response to the reference rate migration, in the critical terms (including changes in eligible benchmark rates) of a designated hedging instrument in a fair value hedge, cash flow hedge, or net investment hedge will not result in a de-designation of the hedging relationship (FASB 2019b). These changes to rebalance or adjust the hedging relationship may include changes in the proportion of the designated hedged item or the derivative designated hedging instrument, adding derivatives to designated hedging instruments, or, for a cash flow hedge, a change in the method used to assess the effectiveness of the hedge (FASB 2019b).

In its September, 2019 final amendments for *Interest Rate Benchmark Reform*, the IASB (2019a) provided that during the reference rate migration period, when determining whether a forecast transaction is highly probable in a cash flow hedge, it should be assumed that "the interest rate benchmark on which the hedged cash flows are based ... is not altered as a result of the interest rate benchmark reform" (¶6.8.4). In the September, 2019 amendments to IAS 39, the IASB provided some relief from retrospective effectiveness assessment by allowing hedge accounting to continue even when, due solely to rate reform uncertainties, hedge effectiveness falls outside the 80% to 125% range (IASB 2019a).

The documentation requirements from the inception of the hedge relationship under both US GAAP and IFRS are specific and extensive. The transition away from IBOR requires up-dating hedge documentation. According to FASB's Exposure Draft, if the *optional expedient* is elected, changes made to the hedging relationships are to be noted in an addendum to the hedge documentation. This addendum is to be provided at the time the entity performs its first assessment of hedge effectiveness after the change (FASB 2019b).

IBOR rates are a key input in discount rates used to value a wide range of assets and liabilities on the entity's balance sheet. Areas of the balance sheet that rely on valuation models that may be affected by the IBOR sunset include assets such as financial instruments, contract sales assets, leases and pensions,

and long-term liabilities such as those related to derivatives, loans, bonds, mortgages, leases, pensions, and certain provisions. IBOR may be used in nonfinancial asset impairment models, and as a basis for determining late payments in some non-financial contracts, for asset return measures and funding costs. The direction and magnitude of the difference between the IBOR and the replacement rate have ramifications not only for the valuation of assets and liabilities on the balance sheet, but for comprehensive income and, frequently, profit and loss, as well. A negative effect on income would likely result from decreases in asset valuations and increases in liability valuations. The impact of the changes to asset and liability valuations would be expected to occur over multiple reporting periods as contracts are renegotiated and fallback provisions are activated. These changes would diminish comparability of financial statement information over time, and increase earnings volatility in these reporting periods.

Additionally, the IBOR sunset is expected to have potential income tax consequences. These consequences could be varied and far-reaching depending upon the taxing jurisdictions. Firms should not forget to consider the impact on their transfer pricing approaches.

The previous discussion is a brief look at some of the potentially significant accounting and financial reporting accounting issues related to the IBOR sunset. For more information on the accounting treatments related to specific assets, liabilities, and equity reserves, refer to the relevant authoritative releases.

The accounting issues (and precipitating taxation effects) as a result of LIBOR's sunset could be significant for your organization. This warrants proactive and comprehensive consideration in the near future.

## HOW FIRMS SHOULD APPROACH TRANSITION

In light of the potential accounting-related issues that could likely arise from the migration from IBOR, firms should evaluate their exposure and operationalize a plan to make the transition. It is important that accounting and finance professionals realize that not just banks are at risk. A quote from Mayer Hoffman McCann P.C. in 2019, illustrates the point: "On the surface, the loss of a benchmark interest rate appears to only affect lending and financial services organizations. The repercussions from the loss of LIBOR, however,



could be felt much more broadly. Many contracts, loans, and other types of financial business arrangements may have references to LIBOR that will need to be modified” (<https://www.mhmcpa.com>).

To approach the task, it is important to make an inventory of the impacted contracts. Particularly significant are those with maturities after 2021, including derivatives and loan contracts, as well as any other valuations. Firms need to identify hedges that rely on IBOR-based rates, evaluate their effectiveness in a post-IBOR environment, and identify their risk exposure. Additionally, the assets and liabilities evaluations that rely on IBOR-based rates need to be identified and new evaluation models must be established.

### Renegotiation of Contracts

For most firms, doing an analysis of IBOR replacement will likely be time consuming and costly; however, it is imperative to do so. Once a firm has determined its IBOR exposure, it must obtain legal opinions as to whether the contracts could be modified or renegotiated. IBOR based debt contracts and hedge agreements that are eligible for modification should state a new index and new fallback arrangements (more on fallbacks in the following). Contracts that cannot be modified, or those with no fallback provisions, will have to be renegotiated. In a recent study by JCRA consultants and Travers Smith LLP (<https://www.jcragroup.com>), 83% of firms reported that they have not yet begun to renegotiate contracts, and only 2% have completed renegotiations. That study also found that 75% of the responding firms stated that they have IBOR-linked contracts that will mature after the IBOR sunset in 2021. Joshua Roberts of JCRA asserts that: “There is going to be a huge amount of renegotiation of contracts in the next few years, and we are concerned that many firms may leave this to the last minute. This will create a significant issue of capacity as there is only a finite number of legal advisers with the expertise necessary to renegotiate these contracts.”

### Alternative Rate

In 2018, ARRC and FASB identified SOFR as a replacement rate for IBOR. In “Leaving LIBOR: A Landmark Transition,” J.P. Morgan identifies some important differences between IBOR and SOFR.

They report that IBOR is an unsecured index rate but SOFR is a secured index rate; IBOR is comprised of various maturities but SOFR is a single overnight rate; IBOR has a built-in credit component but SOFR carries minimal credit risk; IBOR is partially transaction-based but SOFR is wholly transaction-based; and IBOR (three-month) is comprised of \$500 million underlying transactions but SOFR is comprised of \$750 billion underlying transactions (<https://www.jpmorgan.com>). As SOFR is a secured rate (IBOR is unsecured), SOFR is generally lower than IBOR. Therefore, a spread adjustment is necessary. The International Swaps and Derivatives Association “is developing spread adjustments for the derivatives market; ARRC has agreed to work on this for cash markets.” (LSTA <https://www.lsta.org>). The IBOR and SOFR differences will likely impact not only derivatives, but other contract negotiations as well. This includes spread adjustments and market valuations of existing contracts and instruments.

### Best Practices

To approach the transition task, a firm’s strategy should include several important components. In the following, we have summarized key elements to be considered.

To begin, firms must determine their exposure to the sunset of LIBOR, and develop and implement a plan to address the transition. This is best accomplished by forming a team charged with studying the scope and impact on your organization and developing and implementing a plan, with the team leader holding a senior-level position to facilitate continuous progress and upper-management support (de Lachica 2018). Determining exposure may not be easy, because many financial contracts are not in electronic form, making the task arduous (Ernst & Young, 2018). The team must develop a procedure to examine such contracts. Thus, devising an efficient and successful method to find and extract key data in contracts, including fallback terms, is critical (Ernst & Young 2018). Because this process will likely be time consuming, firms should start as early as possible (Twomey 2019). Operational assessment should involve identifying existing “systems, models and processes that are linked to current IBORs,” and inventory management should allow for monitoring exposures and insuring a portfolio of both cash products and hedging agreements (Ernst & Young 2018).

Once assembled, the team should study the ultimate effect on reported income and other accounting considerations before any contracts are modified or renegotiated because volatile reported earnings could result (PwC 2018). Such earnings trends are unfavorable to markets so the possible affects should be examined. Also, any necessary renegotiation of terms could also affect accounting outcomes; other parties to the contract may be unwilling to accept proposed modifications and amendments that will affect their reported earnings negatively (Ernst & Young 2018). Again, resolving these issues will likely be time consuming.

Once the transition team has determined the scope and impact, it should categorize exposure between those contracts/instruments that are maturing before the IBOR sunset, and those that have longer maturities, and identify contracts that may require renegotiation (de Lachica 2018).

Because of the relatively short window of opportunity to get the transition under control, the Loan Syndications and Trading Association (LSTA) indicates that firms should not wait until 2021 to discontinue the practice of writing new contracts that reference IBOR (LSTA 2018). The report suggests including strong fallback provision language going forward. LSTA suggests that fallback provisions should include language that names the reference rate, specifies the event(s) that would trigger transition from the referenced rate, a description of the spread adjustment that would result when transition occurs, and a description of the amendment process (LSTA 2018).

The ARRC has released fallback language recommendations for both floating rate notes and syndicated loans that include the features stated previously. For spread adjustments, the suggested language for floating rate notes includes reference to a “waterfall” (a series of sequenced computations) that results in the spread adjustment that would be used to modify the successor rate (Xu et al. 2019). For more on the waterfall sequence, see “ARRC Releases Recommended Fallback Language for Floating Rate Notes and Syndicated Loans” by Xu et al. (2019). As described, SOFR is generally lower than IBOR so the spread adjustment would result in a “SOFR + Spread” that would equal a rate similar to the IBOR rate. The ARRC has released fallback language for both bilateral business loans and securitizations (ARRC 2019).

According to a recent report (Ernst & Young 2018), the transition team’s impact assessment should

## EXHIBIT 2

### Suggested Sequence of Activities

1. Form a team led by a key person to accomplish the following steps.
2. Initiate a procedure to examine contracts and extract information.
3. Determine firm’s exposure to the sun-setting of IBOR.
4. Identify contracts that will need renegotiation.
5. Examine existing IBOR related internal procedures.
6. Design a plan to address the transition.
7. Assess the possible effect of the response on net income.
8. Implement the plan to address the transition.
9. Continue to monitor guidance from rule makers.
10. Communicate with appropriate stakeholders.

*Notes: This is a suggested general sequence. Variations may be more appropriate for specific companies.*

be comprehensive and include assessments of products, legal contracts, risk, operational considerations, and inventory management. The report also suggests that product assessment should include features such as “maturity, optionality, counterparty, client segment, business and jurisdiction.” Contract assessment should ascertain the nature and extent of fallback provisions; and risk assessment should include an analysis of the income, liquidity and solvency effects of moving to a new benchmark.

It is also valuable to communicate information regarding the firm’s transition efforts to all stakeholders. Such communication should be tailored to the specific concerns and informational needs of the particular group(s). In the event that the transition is not smooth for a certain firm, having communicated fully with its stakeholders will promote trust and confidence in the organization’s efforts.

Finally, firms should also continue to monitor guidance from rule makers going forward (PwC 2018), and should develop strategies to continually communicate with and update all parties involved, both internally and externally, and continue to assess all contracts and LIBOR linked instruments during the transition period (Ernst & Young 2018).

The aforementioned is not intended to be an exhaustive list; rather, it is the basic elements that should be included in any IBOR transition strategy. Exhibit 2 provides a suggested sequence of the activities. Firms must decide on the best approach based on their particular holdings and vulnerabilities.

## SUMMARY

At the end of 2021, banking regulators will no longer encourage or require member banks to provide IBOR submissions. The transition away from IBOR will impact trillions of dollars of loans, bonds, and hedging instruments. The transition is expected to have wide-ranging impacts. It will not only impact companies that have borrowed or lent funds based on an IBOR index and that have one or more derivative contracts based on an IBOR index, but also companies with assets and liabilities subject to valuation models that rely on IBOR-based discounting rates (Brown et al. 2018). In this article, we provide a brief history of the actions taken thus far by regulators and market participants pertaining to the IBOR transition, provide an explanation of the issues and resulting accounting implications, and suggest best practices to manage the transition. The motivation of this article is to underscore the importance of the issue and its wide-ranging impact. Last, it is crucial that business start preparing now for the upcoming transition.

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## ADDITIONAL READING

### LIBOR and EU Securitization Changes

ANDRIANA LOUKANARI AND CHRISTIAN BERARDO

*The Journal of Structured Finance*

<https://jsf.pm-research.com/content/25/3/40>

**ABSTRACT:** Two major regulatory changes will significantly affect collateralized loan obligations (CLOs): the phasing out of support for LIBOR in 2021 and the European Union Securitization Regulations, which came into effect in January 2019. These changes will affect borrowers of capital, investment managers who securitize loans, investors in CLOs, and activity of trustees in this market. As markets prepare to transition away from LIBOR, the Fed's Alternative Reference Rates Committee has established the secured overnight financing rate (SOFR) as its recommended benchmark interest rate. A collateral manager's transition to using SOFR may require the assistance of a trustee to navigate the change. The EU Securitization Regulation imposes new standards of transparency, risk retention, and due diligence for issuers of and investors in securitizations. The new regulation will affect issuers of securitizations in any jurisdictions that market their products to investors in the EU. With a changing market, collateral managers and trustees should be prepared with language and systems in place to manage the transitions they may face. Ensuring that all parties are informed and prepared will abate market uncertainty and provide continuity.

### LIBOR Replacement—The Long and Winding Road

THOMAS M. HUGHES

*The Journal of Structured Finance*

<https://jsf.pm-research.com/content/25/2/28>

**ABSTRACT:** LIBOR is foundational to global markets, but its design makes it unsuitable for the many uses to which it is put, creating enormous regulatory pressure to retire LIBOR in favor of more suitable benchmarks. Replacing LIBOR, however, is throwing up a new set of risks for market participants, some of which have been foreseen, and some of which are emerging as the transition gets under way. This article anatomizes those risks and roots them in the history of modern finance.

### LIBOR—Hazards on the Road to Reform

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**ABSTRACT:** The London Interbank Offered Rate (LIBOR) is one of the most widely used reference rates in the world of finance. Recent information indicates that nearly \$200 trillion in contractual exposures reference USD LIBOR, of which roughly 95% is notional amount exposure under derivatives contracts, with approximately \$8 trillion in exposure under corporate loans, consumer debt (primarily mortgages), floating-rate notes, and securitized products. As described in this article, the future of LIBOR is uncertain, and it may be phased out altogether in favor of new reference rates based on much more robust market data. This article describes the reasons for LIBOR's potential demise, its replacement in the United States, and the impact on legacy assets and asset-backed securities (ABS) transactions in the United States.

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