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CFO JOURNAL

U.S. Companies Advised to Prepare for Multiple Benchmark Rates in Transition from Libor

Globally expanding businesses need to look beyond the replacement created by the Federal Reserve, advisers say

The Federal Reserve's secured overnight financing rate is only one of multiple benchmarks replacing Libor. PHOTO: BRENDAN SMIALOWSKI/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Mark Maurer

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BOSTON—Advisers to globally expanding U.S. companies are recommending that they prepare to use several short-term lending benchmarks when the London interbank offered rate falls out of use.

Libor is a scandal-plagued benchmark that is used to set the price of trillions of dollars of loans and derivatives globally. A group of banks and regulators in 2017 settled on a replacement created by the Federal Reserve known as the secured overnight financing rate, or SOFR. Companies must move away from Libor by the end of 2021, when banks will no longer be required to publish rates used to calculate it.

“We don’t expect that 100% of the Libor-based positions today will migrate 100% to SOFR,” Jeff Vitali, a partner at Ernst & Young, said this week during a panel at an Association for Financial Professionals conference in Boston. “It is going to be a scenario where entities are going to have to prepare and be flexible and build flexibility into their systems and models and processes that can handle multiple pricing environments in the same jurisdiction.”

U.S. businesses that plan to acquire or have acquired non-U.S. businesses and funded those deals through floating debt should be aware of where markets in other countries are in the Libor-transition process. Those companies will also have to prepare for the Libor replacement selected by other countries, such as the various rules governing, for example, €STR, or euro short term rate, in the euro region or Tonar, or Tokyo overnight average rate, in Japan.

Companies have been slow to prepare for the switchover, which involves assessing any inventory that had exposure to Libor and amending contracts for existing financial instruments, including credit cards, corporate loans and derivatives. Since July 2018, businesses have sold about $300 billion of floating-rate debt linked to SOFR, a small fraction of similar debt linked to Libor during that period, according to exchange operator CME Group.

“Like with all the new accounting standards, people tend to wait until the last minute and they rely on their banks and their vendors to prepare everything for them,” Peter Seward, vice president of business development at treasury software provider GTreasury, said in an interview.

Companies most affected by the transition are ones that are capital-intensive. Examples include companies from the manufacturing, real-estate and energy industries.

SOFR, a so-called risk-free rate benchmark, could lead to a lengthy wait time before a company develops liquidity, Rob Mangrelli, director of global real-estate hedging and capital markets at

Chatham Financial Corp., a financial risk adviser, said during a panel at the conference.

The Financial Accounting Standards Board and the International Accounting Standards Board have made efforts to provide additional relief to companies affected by global reference rate overhauls.

Companies are expected to spend about $155 billion on technology, staffing and client outreach as part of the transition away from Libor, according to consulting firm Accenture.

The uncertainty surrounding the shift could translate to higher corporate borrowing costs or reduce company profits and stock prices.

—Daniel Kruger contributed to this article.

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