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MARKETS

Companies Give Investors a Peek at Life After Libor

Interest-rate benchmark set to expire at the end of 2021; companies begin disclosing risks linked to transition

Mondelez International, maker of Cadbury chocolates, said it doesn't anticipate the Libor discontinuation will have a significant impact on its financial position. PHOTO: ANTHONY DEVLIN/PA WIRE/ZUMA PRESS

By Tatyana Shumsky

March 2, 2019 7:00 am ET

Corporate finance teams are rifling through loans, investments and derivatives to assess the potential fallout from moving to a new benchmark for short-term borrowing costs.

CFOs at companies including spice maker McCormick & Co. and food giant Mondelez International Inc. are starting to share those concerns with investors in quarterly earnings reports. The disclosures come as global financial regulators prepare to wind down the London interbank offered rate, or Libor, now used in setting interest rates on hundreds of trillions in debt from mortgages to corporate loans.

Companies are charting the move away from Libor after a series of market-rigging scandals led to billions of dollars in fines for banks and prison sentences for several traders. Global financial regulators have been working on alternative benchmarks and plan to discontinue the Libor, which underpins an estimated $200 trillion of transactions, at the end of 2021.

As that deadline looms, finance chiefs and their staffs are developing plans for what needs to change now and what happens after the switch, lawyers and accountants said. The uncertainty surrounding the shift—as well as the changeover process itself—could translate to higher corporate borrowing costs and even dent company profits and stock prices.

“It’s becoming more of a risk every day that goes by,” said Adam Gilbert, partner and global regulatory leader at PricewaterhouseCoopers. “It’s definitely becoming more important for firms to do an impact assessment, analysis and plan a road map for the transition.”

Dozens of companies including McCormick, Mondelez and American Express Co. have in recent weeks added disclosures about the risks of moving away from the Libor to their filings.

Hunt Valley, Md.-based McCormick—which has a $1 billion revolving credit facility and portions of $1.3 billion in variable-rate short-term debt tied to Libor—warned investors that the reforms, proposals and other pressures on the Libor could cause the rate to behave differently than in the past or disappear entirely.

“The consequences of these developments with respect to Libor cannot be entirely predicted but could result in an increase in the cost of our variable rate debt,” the spice maker said.

A McCormick spokeswoman declined to comment beyond the company’s public statements.

Libor-related disclosures will become more detailed in the coming quarters as regulatory efforts to establish alternative benchmarks advance and as companies get a firmer grasp of the risks, lawyers and accountants said. Finance chiefs don’t yet have a clear path to transition away from the benchmark, limiting what they can tell investors, but that doesn’t mean they can put off the work.

“Now is the time that companies need to understand the extent of the issue with their debt, because if they wait too long they’re going to be really jammed,” said Geoffrey Peck, partner at Morrison & Foerster LLP.

Companies must look at three areas—borrowing, derivatives and investments—when assessing the scope of their exposure, said Roy Choudhury, the Americas capital markets advisory leader at Ernst & Young LLP. They must also consider any implications for hedging and hedge accounting, as well as how the risk varies by currency and jurisdiction.

“This is not just a U.S. dollar problem, this is a euro problem, really all of the major currencies,” Mr. Choudhury said.

Mondelez added discussion of the Libor's planned discontinuation to its annual report last month but said it doesn't anticipate this will have a significant impact on its financial position given its current mix of debt. The maker of Oreos cookies and Cadbury chocolates had two revolving credit facilities totaling $6 billion at the end of 2018 that allow for Libor-based loans, but the company hasn't currently borrowed against them.

A Mondelez spokesman declined to comment beyond the company's disclosures.

Financial institutions are slightly ahead of the curve when it comes to telling shareholders about the risks surrounding the Libor, in part because the rate forms the basis of so many of the products these companies sell and trade. For the eight U.S. global systemically important banks, roughly 30% of the balance sheet is linked to the Libor and around half of that exposure matures after 2021, according to EY.

American Express said it has around $27 billion of Libor-indexed debt, according to the company's annual report filed in February. That is down from $33 billion a year earlier.

The credit-card company expanded its disclosures to add that both the uncertainty surrounding the Libor's future, the Libor's potential discontinuation and any potential transition to alternative benchmarks could impact Amex.

"At this time, it is not possible to predict the effect that these developments...may have on the markets, us or our floating rate debt securities," Amex said in its annual report.

An Amex spokesman declined to comment beyond the disclosures.

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