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"Synthetic LIBOR" — What is it?

By Erik Schneider

A new term, "synthetic LIBOR," has come into usage of late, sounding possibly like a knight in shining armor to save us from the pains of the forthcoming LIBOR transition.[1] However, "synthetic LIBOR" is neither synthetic nor will it likely be the rate that the term "LIBOR" has defined since it was first used in 1986. As often as the new term "synthetic LIBOR" is mentioned, its exact meaning is rarely explained. Here is an explanation.

The term began circulating in the leveraged loan and floating rate bond markets after the UK government announced in late June 2020 that it intends to amend the UK regulations of benchmark interest rates to give the Financial Conduct Authority ("FCA") enhanced powers, including the power to select a new calculation methodology to any benchmark.[2] This includes the power to direct the administrator of LIBOR to change the methodology of LIBOR if the FCA determines that the current LIBOR methodology (i.e., polling of panel banks) is no longer representative of the market and if it would be both more appropriate and feasible to change to an alternative methodology. This new methodology would result in a new interest rate being published as the "screen rate" instead of LIBOR. In other words, the Intercontinental Exchange intends to publish a new rate on the same screen and in the same location on the screen where it had previously published LIBOR.

However, it is important to understand that, as envisioned by the FCA, this new rate would not replicate LIBOR through some synthetic calculation. Rather, in the accompanying FAQs[3] the FCA explains that the new methodology would follow the market consensus that emerges on how to calculate fair alternatives to LIBOR. For most currencies, this will be a risk-free rate chosen by the applicable LIBOR currency area, adjusted for the relevant term of the contract, and with a fixed credit spread adjustment added. In other words, for the USD LIBOR market, "synthetic LIBOR" would likely be SOFR plus a modifier.

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[1] LIBOR is not expected to be published commencing in 2022 based on the FCA announcement in July 2017 that it will no longer compel or seek to persuade participant banks to submit the rates used to calculate LIBOR after December 31, 2021. That announcement is [available here](#).

[2] See [Financial Services Regulation Statement made on 23 June 2020](#).

[3] See [Benchmarks Regulation—proposed new powers](#).

The FCA's stated goal for such a "synthetic LIBOR" is to provide an additional tool that might facilitate the transition of certain so-called "tough legacy" LIBOR contracts.[4] The FCA and other regulatory authorities across the globe continue to strongly urge market participants to focus on proactively amending financial contracts that use LIBOR in advance of the rapidly approaching deadline of December 31, 2021.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

— Erik Schneider, 617-345-1112, eschneider@nixonpeabody.com

[4] See "FCA statement on planned amendments to the Benchmarks Regulation," (June 23, 2020).