THE END IS NIGH-BOR FOR GOOD OLD LIBOR: IMPORTANT TRANSITION DATES AS NEW YORK LEGISLATIVE FIX BECOMES LAW

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U.S. Finance Alert

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This is an update on recent events in the cessation of the London Inter-bank Offered Rate (LIBOR):

- InterContinental Benchmark Exchange (ICE), the organization that administers and announces LIBOR, and the United Kingdom's Financial Conduct Authority (FCA), ICE's regulator, announced on 5 March 2021:
  - LIBOR for most currencies and maturities will cease after 31 December 2021.
  - U.S. dollar LIBOR for overnight, one-month, three-month, six-month, and 12-month maturities will cease after 30 June 2023.
  - LIBOR is not expected to become unreliable prior to the cessation date applicable to the relevant currency and maturity.
- The announcements are a "Benchmark Transition Event" per the Alternative Reference Rate Committee's (ARRC) standard fallback language,[1] which has been the basis for much recent drafting and many recent contract amendments.
- They also establish for each related currency and maturity a "Benchmark Transition Date" for triggering operational changes for using another interest rate index.
- The International Swaps and Derivatives Association (ISDA) used the announcement date of 5 March 2021 to set "fallback spread adjustments" for derivatives; this value should be available now on Bloomberg for all currencies and maturities.
- On 9 March, the Board of Governors of the Federal Reserve System issued guidance to examiners for evaluating supervised firms' LIBOR transition efforts; it noted that firms should stop issuing LIBOR-referencing contracts by 31 December 2021 and that new contracts should contain robust fallback language for LIBOR cessation and transition.
- On 7 April 2021, New York enacted a law designed to transition unamendable LIBOR-referencing contracts containing no fallback language to a new interest rate index after LIBOR's cessation.
- Tax guidance on LIBOR cessation has been proposed.

On 5 March 2021 ICE announced that it would cease publishing LIBOR for all non-U.S. dollar currencies and for U.S. dollar one-week and two-month LIBOR immediately after publishing a final LIBOR for these currencies and maturities (or "tenors") on 31 December 2021.[2] ICE will only continue to publish U.S. dollar LIBOR for overnight, one-month, three-month, six-month, and 12-month maturities until 30 June 2023, both absent intervention from the FCA, ICE's regulator.

Simultaneously, the FCA published an announcement that all LIBOR for all currencies and maturities will either cease to be provided by ICE or will no longer be representative either (i) immediately after 31 December 2021 in the case of all United Kingdom Pounds Sterling, Euro, Swiss Franc, and Japanese Yen currencies, and the one-week and two-month U.S. dollar maturities; (ii) or immediately after 30 June 2023 in the case of the remaining U.S. dollar maturities.[3] Importantly, the FCA stated that it did not expect any LIBOR for any currencies or maturities to become "unrepresentative" prior to their cessation dates; LIBOR after the cessation dates would be considered to be "unrepresentative." Becoming "unrepresentative" is one possible trigger in the ARRC's standard fallback language.

Finally, many LIBOR-referencing documents are hedged with derivatives. ISDA, which provides draft language used in many derivatives, noted that the announcement by the FCA constituted an "index cessation event" under its IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all LIBOR currencies and maturities (including the LIBOR U.S. dollar maturities continuing into 2023).[4] Thus, the fallback spread adjustment had been fixed as of 5 March 2021 for all currencies (including U.S. dollar LIBOR) for all maturities.

The ARRC, an organization of the Federal Reserve Bank of New York's members and market participants, published a notification on 8 March 2021 that the 5 March 2021 statements from ICE and the FCA on the future cessation of LIBOR and expectations about loss of representativeness constituted a "Benchmark Transition Event" with respect to all U.S. dollar LIBOR maturities pursuant to its recommendations regarding more robust fallback language for new issuances and originations.[5] The trigger for when fallback language in a document using the ARRC's standard fallback language would become operative is generally the "Benchmark Replacement Date" defined term.

It bears noting that not all U.S. dollar LIBOR-referencing documents use the ARRC's standard fallback language and that amendments to account for recent developments may be needed. Other documents are not subject to being amended due to one needed party no longer being in existence or having LIBOR-based fallback provisions (e.g., requiring a party to call select banks for LIBOR quotations and then averaging them in the event LIBOR ceases to be published), among other reasons.[6] Some contracts, particularly for REMICs, may require a tax opinion for amendments to be made or for index changes to be implemented, so the pending tax guidance discussed below may be relevant.

On 9 March, the Board of Governors of the Federal Reserve System issued a supervisory letter[7] providing guidance to examiners regarding supervised firms' implementation and funding of LIBOR transition plans. Firms were cautioned that their issuance of new LIBOR-based contracts after 31 December 2021 would create "safety and soundness" risks. New LIBOR-based contracts would need to have robust fallback language for LIBOR cessation and transition. Firms would need to be aware of existing LIBOR-referencing contracts, need to know which contracts would extend beyond the related Benchmark Replacement Date, and work with vendors needed to implement needed changes, among other things.

On 7 April 2021 New York Governor Andrew Cuomo signed into law the LIBOR Discontinuance Legislation (S. 297), which had been introduced as part of the 2020-2021 Fiscal Year New York State Executive Budget. S. 297 was designed to provide a fallback benchmark transition for contracts governed by New York law that do not have adequate provisions to determine what will happen when U.S. dollar LIBOR ceases to be published. Such contracts are referred to as "tough legacy" contracts. S. 297 would do this by mandating that "tough legacy" contracts be subject to the ARRC-proposed fallback language by operation of law.[8] "Tough legacy" contracts were regarded by many participants in the financial markets as a largely unprecedented matter of great concern, affecting a large number of contracts, each with unique language. To mitigate the risk of economic disruption, S. 297 mandates the use of standard benchmark replacement language for contracts that with no or inadequate fallback language. S. 297 is modeled on a 1997 New York statute that required that references in sovereign currencies being replaced by the Euro be replaced by references to the Euro by operation of law. The New York statute does not cover certain types of transactions, and it does not cover contracts that have a benchmark other than U.S. dollar LIBOR. In addition, it does not resolve issues under federal law. One such federal law issue is whether the modification of a benchmark in an indenture that is require to be qualified under the Trust Indenture Act would violate Section 316(b) of that act, which mandates that "the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security…shall not be impaired or affected without the consent of such holder." Finally, in the United States, the Internal Revenue Service has issued Proposed Regulations[9] in 2019 and Revenue Procedure 2020-44[10] last year to help parties address tax issues that may be associated with the amendment of contracts to add LIBOR fallback language, change interest rate indices, and change interest rate spreads, among other things, that may occur in connection with LIBOR's cessation. Various organizations have commented on the Proposed Regulations, which have yet to be finalized or re-proposed in light of the comments, the rise of SOFR as the preferred fallback to U.S. dollar LIBOR, and the events over the past year.

FOOTNOTES

[1] The ARRC's standard fallback language for various financial products is found here. This language generally includes a series of fallbacks to implement upon LIBOR's cessation, including various ways to implement the secured overnight funding rate (SOFR), whether in term SOFR format (n.b., term SOFR does not exist yet) or variations on an average of daily SOFR rates over a period of time.

[2] ICE Benchmark Administration Publishes Feedback Statement for the Consultation on Its Intention to Cease the Publication of LIBOR® Settings.

[3] Announcements on the end of LIBOR.

[4] ISDA Statement on UK FCA LIBOR Announcement.

[5] ARRC Confirms a "Benchmark Transition Event" has occurred under ARRC Fallback Language. Frequently-asked questions about the announcement can be found here.

[6] These contracts are referred to as "tough legacy" contracts.

[7] SR 21-7: Assessing Supervised Institutions' Plans to Transition Away from the Use of the LIBOR.

[8] Senate Bill S297B.

[9] Guidance on the Transition From Interbank Offered Rates to Other Reference Rates.

[10] Rev. Proc. 2020-44.

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