

March 17, 2022

Federal LIBOR Transition Legislation

“Adjustable Interest Rate (LIBOR) Act” Is Enacted to Provide a Uniform, National Solution for “Tough Legacy” Contracts

SUMMARY

On March 15, 2022, President Biden signed into law the “Consolidated Appropriations Act, 2022,” which enjoyed significant bipartisan support and contains, as Division U, the “Adjustable Interest Rate (LIBOR) Act” (the “LIBOR Act”).¹ The LIBOR Act provides a uniform national approach for replacing U.S. dollar LIBOR (“LIBOR”) as a reference interest rate in so-called “tough legacy” contracts (contracts that do not include effective fallback provisions, for example, because they have no provisions for a replacement benchmark or their fallback provisions would require the use of a LIBOR-based rate or a poll to determine a rate) for a time when LIBOR is no longer published or is no longer representative. Under the LIBOR Act, references to the most common tenors of LIBOR (the overnight, one-month, three-month, six-month and 12-month tenors) in these contracts will be replaced as a matter of law, without the need to be amended, to instead reference a benchmark interest rate that will be identified in regulations of the Board of Governors of the Federal Reserve System (the “Federal Reserve”). The Federal Reserve must promulgate these regulations by September 11, 2022, the date that is 180 days after the statute’s enactment. Any Federal Reserve-identified replacement benchmark will be based on the Secured Overnight Financing Rate (“SOFR”), a rate published by the Federal Reserve Bank of New York (the “FRBNY”), and will include an appropriate “tenor spread adjustment” to reflect historical spreads between LIBOR and SOFR. The statute also provides a “safe harbor,” under which a party that has discretion to select a replacement for LIBOR may choose to adopt the replacement benchmark identified by the Federal Reserve.

BACKGROUND

The Federal Reserve and other federal banking agencies have noted over several years the importance to institutions of an orderly transition away from the use of LIBOR, including by highlighting risks associated

with the discontinuation of LIBOR and encouraging institutions to continue efforts to transition to alternative benchmarks.² The agencies have, for example, described that “[f]ailure to adequately prepare for LIBOR’s discontinuance could undermine financial stability and institutions’ safety and soundness and create litigation, operational, and consumer protection risks.”³

The timing of LIBOR’s cessation was fixed on March 5, 2021, when ICE Benchmark Administration Limited (“IBA”), the benchmark administrator for LIBOR, stated that it would cease publication of the overnight, one-month, three-month, six-month and 12-month tenors of LIBOR after June 30, 2023.⁴ Also on March 5, 2021, the U.K. Financial Conduct Authority (“FCA”), which supervises IBA under the Benchmarks Regulation, confirmed that, after June 30, 2023, those LIBOR tenors would no longer be provided by any administrator or would no longer be representative.⁵

To address issues associated with “tough legacy” contracts, on April 6, 2021, the State of New York adopted legislation that deemed LIBOR to be replaced by operation of law in these contracts as of the date LIBOR ceases to be published (or is announced to no longer be representative), with a benchmark rate based on SOFR.⁶ Alabama adopted similar legislation later in the same month.⁷

Also in 2021, Congress began consideration of legislation that would provide a national framework for addressing issues with “tough legacy” contracts. Federal LIBOR legislation has been supported by Treasury Secretary Janet Yellen, Federal Reserve Chair Jay Powell and others,⁸ and the U.S. House of Representatives passed stand-alone LIBOR-related legislation in December 2021 by a vote of 415 to 9.⁹

THE LIBOR ACT

The LIBOR Act is similar to the stand-alone legislation previously adopted by the House of Representatives. The LIBOR Act provides that it seeks to “establish a clear and uniform process, on a nationwide basis,” for replacing LIBOR in contracts without effective fallback provisions and, in so doing, to “preclude litigation” in respect of the over \$200 trillion of contracts worldwide that reference LIBOR as a benchmark interest rate, many of which do not provide effective fallback provisions. The legislation explicitly does not affect the ability of parties to “use any appropriate benchmark in new contracts” and allows existing contracts that reference LIBOR but include effective fallback provisions “to operate according to their terms.”¹⁰

The provisions of the LIBOR Act cover “LIBOR contracts,” which include agreements of any type—such as indentures, debt securities, equity securities, leases, other instruments and other obligations or assets—that by their terms use the overnight, one-month, three-month, six-month or 12-month tenor of LIBOR as a benchmark interest rate. LIBOR contracts under the LIBOR Act do not include agreements that reference the less-common one-week or two-month LIBOR tenors.¹¹

Among other things, the LIBOR Act (i) provides for the mandatory, automatic replacement of LIBOR references with a Federal Reserve-identified replacement benchmark in LIBOR contracts that include

certain ineffective fallback provisions; (ii) authorizes persons that may exercise discretionary authority to select a LIBOR replacement to opt into a statutory safe harbor by selecting the Federal Reserve-identified benchmark; (iii) provides that parties may opt out of the LIBOR Act; and (iv) provides that the legislation has no effect on LIBOR contracts that include effective fallback provisions identifying an appropriate replacement benchmark. The LIBOR Act also includes a provision limiting supervisory criticism of banks that use benchmark interest rates that are not based on SOFR.

A. TREATMENT OF LIBOR CONTRACTS

1. LIBOR contracts with ineffective fallback provisions. The mandatory replacement provision of the LIBOR Act applies to LIBOR contracts that lack effective fallback language because they (i) do not include any fallback provision; (ii) include fallback provisions that identify neither a specific replacement benchmark nor a person (a “determining person”) with authority to determine a replacement benchmark;¹² (iii) include fallback provisions that specify a replacement that is itself based on LIBOR;¹³ or (iv) include fallback provisions that require a person (other than a benchmark administrator) to conduct a poll of interbank lending or deposit rates to determine a replacement rate. For any such contract, references to LIBOR will be replaced by operation of law with the replacement benchmark identified by the Federal Reserve, plus a “tenor spread adjustment” that represents, as described below, the historical spread between LIBOR and SOFR for the applicable tenor.¹⁴ This replacement will occur without triggering any consent rights or otherwise being deemed to impair or affect contract rights.¹⁵ Any additional conforming changes included in the Federal Reserve’s regulations, as described below, will also automatically be incorporated as an integral part of the contract.¹⁶

The regulations that the Federal Reserve is required to promulgate within 180 days of the LIBOR Act’s enactment must identify the SOFR-based replacement benchmark for each of the relevant LIBOR tenors and any “conforming changes” that will also automatically be incorporated in applicable LIBOR contracts.¹⁷ These conforming changes may include any “technical, administrative, or operational” changes that the Federal Reserve determines would “address 1 or more issues affecting the implementation, administration, and calculation” of the identified replacement benchmark.¹⁸

The automatic replacement of LIBOR with the identified replacement benchmark plus a tenor spread adjustment, as well as the integration of the conforming changes specified by the Federal Reserve, will occur on the applicable “LIBOR replacement date”—the first London banking day after June 30, 2023, unless the Federal Reserve determines the relevant LIBOR tenor will cease to be published or cease to be representative on a different day.¹⁹ As of the LIBOR replacement date, for non-consumer loans, the tenor spread adjustment added to the relevant replacement benchmark will be an adjustment specified in the LIBOR Act.²⁰ The LIBOR Act’s adjustments are the same as the spread adjustments recommended by the Alternative Rates Reference Committee (the “ARRC”), which is convened by the Federal Reserve and the FRBNY, and the International Swaps and Derivatives Association (“ISDA”). Those recommended

adjustments were calculated for each tenor of LIBOR as of March 5, 2021 (the date of IBA's and FCA's announcements regarding the cessation of the applicable LIBOR tenors) using the five-year median difference between the relevant LIBOR tenor and a term-adjusted SOFR rate.²¹

For consumer loans, there will be a one-year transition period in applying the tenor spread adjustment specified in the LIBOR Act. That is, for these loans—which generally include lending transactions to a natural person that are primarily for personal, family or household purposes²²—the adjustment to the Federal Reserve-identified replacement benchmark will transition linearly over a year from the actual spread between the applicable LIBOR tenor and the replacement benchmark, as of immediately before the LIBOR replacement date, to the tenor spread adjustment specified in the LIBOR Act.²³

2. LIBOR contracts that provide discretionary authority to select a replacement rate. With respect to LIBOR contracts that authorize a “determining person” to select a replacement benchmark,²⁴ the LIBOR Act provides a safe harbor that applies if the determining person selects the Federal Reserve-identified benchmark as a LIBOR replacement. That safe harbor generally provides that no person may be subject to any claim or liability arising out of selecting or using the Federal Reserve identified-benchmark or implementing conforming changes permitted under the LIBOR Act.²⁵ To opt in to the safe harbor, the determining person must irrevocably select the Federal Reserve-identified benchmark as the LIBOR replacement to apply on and after the LIBOR replacement date, and must make this selection no later than the earlier of the applicable LIBOR replacement date and the latest selection date authorized in the contract.²⁶ If a determining person does not make a selection by the specified deadline, the Federal Reserve-identified benchmark will automatically become the replacement.²⁷

When the Federal Reserve-identified benchmark is the replacement for these LIBOR contracts, (i) the conforming changes promulgated by the Federal Reserve in its regulations will also automatically become part of the contract;²⁸ (ii) for any non-consumer loan, a “calculating person” responsible for calculating any valuation, payment or other measurement based on a benchmark interest rate may incorporate any additional conforming changes that the person reasonably determines to be “necessary or appropriate to permit the implementation, administration, and calculation of the” replacement benchmark;²⁹ and (iii) the tenor spread adjustment specified in the LIBOR Act will apply immediately for non-consumer loans and will be subject to the same one-year transition period described above for consumer loans.³⁰

Notwithstanding the availability of the safe harbor, the LIBOR Act provides that there may be no negative inference or presumption drawn with respect to the validity or enforceability of any replacement benchmark in a LIBOR contract that is not the Federal Reserve-identified replacement or any contract modifications that are not the conforming changes specified in the Federal Reserve's regulations.³¹

3. LIBOR contracts that specify a replacement rate. In accordance with the legislative purpose of “allow[ing] existing contracts that reference LIBOR but provide for the use of a clearly defined and practicable replacement rate” to “operate according to their terms,”³² the LIBOR Act provides that it does

not alter or impair any LIBOR contract that (i) opts out of the legislation's provisions or (ii) contains effective fallback provisions that identify a replacement rate (e.g., the prime rate or effective federal funds rate), as long as that replacement rate is not based in any way on LIBOR.³³

4. Application of trust indenture act. The LIBOR Act amends Section 316(b) of the Trust Indenture Act of 1939 (the "TIA"), which provides generally that, with respect to securities issued under an indenture qualified under the TIA, the rights of a holder to receive payment of principal and interest when due and to sue for the enforcement of any such payment may not be impaired or affected without the holder's consent.³⁴ The amendments under the LIBOR Act clarify that these rights are not impaired or affected, and therefore no holder consent is required, in connection with any automatic replacement of a LIBOR reference in a LIBOR contract with the Federal Reserve-identified replacement benchmark or any selection by a determining person of that benchmark as a LIBOR replacement.³⁵

5. Preemption of state law. The LIBOR Act expressly preempts any state law that (i) relates to the selection or use of a benchmark replacement for the overnight, one-month, three-month, six-month and 12-month tenors of LIBOR or related conforming changes; or (ii) expressly limits how interest is calculated with respect to the Federal Reserve-identified replacement benchmark. Accordingly, the statute preempts the New York and Alabama statutes discussed above, except with respect to the relatively uncommon one-week and two-month LIBOR tenors.³⁶

B. LIMITS ON SUPERVISORY CRITICISM OF NON-SOFR-BASED LOANS

In November 2020, the federal banking agencies issued guidance noting that, although the ARRC has recommended SOFR as its preferred alternative to LIBOR, the use of SOFR is "voluntary." That guidance also stated that there are differences in bank funding models, lending activities and customer needs that could influence what reference rate is most appropriate in specific circumstances.³⁷ In line with this guidance, the LIBOR Act provides that any federally supervised bank may use any benchmark, other than U.S. dollar and non-U.S. dollar settings of LIBOR, that the bank determines to be appropriate for its funding model, the needs of its customers, and its products, risk profile, risk management capabilities and operational capabilities. Further, the LIBOR Act provides that no federal supervisory agency may initiate an enforcement action or otherwise issue supervisory criticism (e.g., a "Matter Requiring Attention" or "Matter Requiring Immediate Attention") solely because a bank uses a benchmark interest rate other than SOFR.³⁸

IMPLICATIONS

The LIBOR Act addresses many of the litigation risks that the LIBOR transition would otherwise create in the case of "tough legacy" contracts. However, certain issues related to the LIBOR transition are not fully addressed in the legislation. For example, the legislation does not address contracts governed by non-U.S. law or how determining persons or calculating persons may exercise the discretion provided under the

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LIBOR Act to select the Federal Reserve-identified replacement rate or determine appropriate conforming changes. Parties that may be affected by these issues should consider appropriate steps well in advance of June 30, 2023.

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ENDNOTES

- 1 H.R. 2471, Div. U. The appropriations legislation containing the LIBOR Act was adopted on March 9, 2022 in the U.S. House of Representatives by a vote of 260 to 171 and in the U.S. Senate by a vote of 68 to 31 on March 10, 2022.
- 2 See, e.g., Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, State Bank and Credit Union Regulations, Joint Statement on Managing the LIBOR Transition (Oct. 20, 2021), *available at* <https://www.federalreserve.gov/supervisionreg/srletters/SR2117a1.pdf> [hereafter, October 2021 Joint Statement]; Board of Governors of the Federal Reserve System, SR 21-7: Assessing Supervised Institutions' Plans to Transition Away from the Use of the LIBOR (Mar. 9, 2021), *available at* <https://www.federalreserve.gov/supervisionreg/srletters/SR2107.htm>; Federal Financial Institutions Examination Council, Joint Statement on Managing the LIBOR Transition (July 1, 2020), *available at* <https://www.ffiec.gov/press/PDF/FFIEC%20Statement%20on%20Managing%20the%20LIBOR%20Transition.pdf>; Speech of Federal Reserve Vice Chair for Supervision and Chair of the Financial Stability Board Randal K. Quarles at the Financial Stability Board Roundtable on Reforming Major Interest Rate Benchmarks (Apr. 10, 2019), *available at* <https://www.federalreserve.gov/newsevents/speech/quarles20190410a.htm>.
- 3 October 2021 Joint Statement, *supra* note 2.
- 4 See ICE Benchmark Administration Limited, ICE LIBOR Feedback Statement on Consultation on Potential Cessation, at 17 (Mar. 5, 2021), *available at* https://www.theice.com/publicdocs/ICE_LIBOR_feedback_statement_on_consultation_on_potential_cessation.pdf. Two less commonly referenced tenors of LIBOR—the one-week and two-month tenors—along with all tenors of Euro, Japanese yen, Pound sterling and Swiss franc LIBOR were no longer to be published immediately after December 31, 2021.
- 5 Financial Conduct Authority, Announcements on the End of LIBOR (Mar. 5, 2021), *available at* <https://www.fca.org.uk/news/press-releases/announcements-end-libor>.
- 6 N.Y. Gen. Oblig. Law Art. 18-C. For further details regarding the New York legislation, see our memorandum to clients, “New York Legislation Addressing LIBOR Cessation: Issuers Should Review Structured Instruments to Identify Any Mismatch in Payments Arising from Differing State Laws” (May 3, 2021), *available at* <https://www.sullcrom.com/sc-publication-new-york-adopts-legislation-cessation-of-US-dollar-LIBOR>.
- 7 Ala. Code § 5-28-1 *et seq.*
- 8 *Oversight of the Treasury Department's and Federal Reserve's Pandemic Response*, Virtual Hearing Before the H. Comm. on Financial Services, 117th Cong. 15 (2021) (statement of Treasury Secretary Yellen), *available at* <https://www.govinfo.gov/content/pkg/CHRG-117hrg44345/pdf/CHRG-117hrg44345.pdf>; *Monetary Policy and the State of the Economy*, Virtual Hearing Before the H. Comm. on Financial Services, 117th Cong. 13 (2021) (statement of Federal Reserve Chair Powell), *available at* <https://www.congress.gov/117/chrg/CHRG-117hrg43967/CHRG-117hrg43967.pdf>; *The End of Libor: Transitioning to an Alternative Interest Rate Calculation for Mortgages, Student Loans, Business Borrowing and Other Financial Products*, Testimony of Mark Van Der Weide, Federal Reserve General Counsel, Before the Subcomm. on Investor Protection, Entrepreneurship, and Capital Markets of the H. Comm. on Financial Services, 117th Cong. (2021), *available at* <https://www.federalreserve.gov/newsevents/testimony/vanderweide20210415a.htm>.
- 9 Adjustable Interest Rate (LIBOR) Act of 2021, H.R. 4616, 117th Cong. (as passed by House, Dec. 8, 2021).
- 10 LIBOR Act, § 102.
- 11 LIBOR Act, § 103(15)-(16).

ENDNOTES (CONTINUED)

- 12 LIBOR Act, § 103(10) (definition of “determining person”).
- 13 These contracts do not include those with fallback provisions that reference LIBOR solely to account for the difference between LIBOR and a replacement benchmark.
- 14 LIBOR Act, § 104(a), (b).
- 15 *E.g.*, LIBOR Act, § 105(a)-(b).
- 16 LIBOR Act, § 104(d).
- 17 LIBOR Act, §§ 103(4)(A), (6), (20), 104(d)(1), (e)(1).
- 18 LIBOR Act, § 103(4)(A).
- 19 LIBOR Act, §§ 103(17), 104(a), (d)(1).
- 20 LIBOR Act, § 104(e)(1).
- 21 See Alternative Rates Reference Committee, Summary of ARRC’s Fallback Recommendations (Oct. 6, 2021), *available at* <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/spread-adjustments-narrative-oct-6-2021>; *see also* ARRC Supplemental Recommendations of Hardwired Fallback Language for LIBOR Syndicated and Bilateral Business Loans, at 5-6, 10, 16 (Mar. 25, 2021), *available at* <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/arrc-supplemental-hardwired-recommendation>; Bloomberg, IBOR Fallbacks: Technical Notice—Spread Fixing Event for LIBOR (Mar. 5, 2021), *available at* https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf.
- 22 LIBOR Act, § 103(8), (9) (referencing the definitions of “consumer” and “credit” in the Truth in Lending Act, 15 U.S.C. § 1602(f), (i)).
- 23 LIBOR Act, § 104(e)(2).
- 24 LIBOR Act, § 103(10) (defining “determining person”).
- 25 LIBOR Act, § 105(c).
- 26 LIBOR Act, § 104(c)(1)-(2).
- 27 LIBOR Act, § 104(c)(3).
- 28 LIBOR Act, § 104(d).
- 29 LIBOR Act, §§ 103(4)(B), 104(d)(2); *see also* LIBOR Act, § 103(7) (defining “calculating person”).
- 30 LIBOR Act, § 104(e).
- 31 LIBOR Act, § 105(e); *see also* LIBOR Act, § 104(f)(3) (providing that the LIBOR Act may not be construed to alter or impair any election by a determining person to use a replacement benchmark other than the Board-identified replacement).
- 32 LIBOR Act, § 102(b)(3).
- 33 LIBOR Act, § 104(f)(1)-(2).
- 34 15 U.S.C. § 77ppp(b).
- 35 LIBOR Act, § 108 (adding 15 U.S.C. § 77ppp(b)(3)).
- 36 LIBOR Act, § 107.
- 37 Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Statement on Reference Rates for Loans (Nov. 6, 2020), *available at* <https://www.federalreserve.gov/supervisionreg/srletters/SR2025a1.pdf>.
- 38 LIBOR Act, § 106.

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