Spring 2021 LIBOR Transition LinkWrap: A Compendium of Recent Developments

Friedman Kaplan LIBOR Transition Task Force

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What's happening right now in the world of LIBOR transition? Friedman Kaplan's LIBOR Transition Task Force sees six major themes:

1. The timetable for the end of compelled submissions to USD LIBOR has changed.

Since the beginning of the COVID-19 pandemic in the first quarter of 2020, there were questions whether the UK Financial Conduct Authority (FCA), which regulates USD LIBOR, would push back the benchmark's announced December 31, 2021 end date. When we last wrote, the official sector was holding fast to the FCA's message from earlier in 2020 that there would be no delay. That all changed quickly in late November 2020.

On November 18, 2020, ICE Benchmark Administration (IBA), the administrator of USD LIBOR and several other LIBOR benchmarks, announced that it would be consulting "on its intention to cease the publication of all GBP, EUR, CHF and JPY LIBOR settings," and stated that "[d]iscussions involving IBA, the Financial Conduct Authority (FCA), other official sector bodies and the panel banks are continuing regarding the future of USD LIBOR."

The same day as IBA's announcement, the FCA published two consultations about proposed policy in relation to new powers granted to the FCA under the Benchmarks Regulation (BMR) as amended by the Financial Services Bill which was introduced into the UK Parliament in October 2020 and became law (as the Financial Services Act 2021 (FSA)) in early May 2021. One of the consultations proposed a policy for the FCA's use of the proposed new power to require continued publication of critical benchmarks on the basis of a changed methodology (i.e., so-called "synthetic" LIBOR) in certain circumstances, and the other set out the FCA's views on the circumstances in which those powers would potentially become relevant. Those consultations closed in January 2021. A further consultation was published on May 20, 2021 regarding the FCA's proposed use of its new powers under the Financial Services Act 2021 regarding the use of critical benchmarks that are being wound down. Responses are due by June 17, 2021.

The International Swaps and Derivatives Association (ISDA) published a statement on the same date of these announcements which clarified that none of them constituted an "index cessation event" under the IBOR Fallbacks Supplement or the ISDA 2020 IBOR Fallbacks Protocol.

On November 30, 2020, IBA announced it would be consulting on "its intention to cease the publication of the one week and two month USD LIBOR settings immediately following the LIBOR publication on December 31, 2021, and the remaining USD LIBOR settings immediately following the LIBOR publication on June 30, 2023." As announced, the IBA launched its consultations in early December 2020, with a closing date of January 25, 2021.

2. "Tough legacy" transactions continue to be a paramount concern as LIBOR transition approaches, with legislative and regulatory tools being deployed.

In late October 2020, legislation was introduced in the New York State Senate to enact statutory provisions relating to the discontinuance of LIBOR, including a prohibition on parties refusing to perform contractual obligations or declaring a breach of contract as a result of the discontinuance of LIBOR or the use of a recommended benchmark replacement; establishing that certain recommended benchmark replacements are commercially reasonable substitutes for and commercially substantial equivalents to LIBOR; and providing a safe harbor from litigation for the use of the recommended benchmark replacement. The Securities Industry and Financial Markets Association announced its support for the proposed legislation a few weeks later, followed by a joint letter from ARRC members giving their endorsement. Governor Andrew Cuomo signed the legislation into law on April 6, 2021.

As noted above, in late October 2020, the UK Government introduced a Financial Services Bill which includes provisions to amend and strengthen the UK's regulatory framework for benchmarks including USD LIBOR. In February 2021, the UK Treasury published a consultation seeking feedback on the need for additional legal protections for parties affected by the wind-down of a critical benchmark, including a "safe harbour" for tough legacy transactions and "legal immunity" for LIBOR's administrator, IBA. That consultation closed in March 2021. Shortly thereafter, the Working Group on Sterling Risk-Free Reference Rates wrote to the UK Treasury lamenting the fact that such provisions would not be included in the Financial Services Bill. The Financial Services Bill became law in early May 2021 – without the safe harbor and continuity of contract provisions urged by the Working Group.

In November 2020, Fed Vice Chair Randal Quarles announced that within coming months the Federal Reserve Board would be providing policies that address approaches to existing LIBOR-linked contracts that mature after the benchmark is due to expire, noting that "[w]e need to consider a mechanism that would allow so-called legacy contracts, the great bulk of them, to mature on their existing basis without having to be renegotiated and shifted to a new rate." In February 2021, almost exactly a year after saying (subscription only) federal legislation was *not* necessary to address LIBOR transition, Fed Chair Jerome Powell told (subscription only) the House Financial Services Committee that "federal legislation is the best answer" to deal with the "hard tail" of the "tough legacy" problem.

The topic of possible federal LIBOR-transition legislation was front and center at an April 2021 hearing of the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets of the House Financial Services Committee. While the specifics of such legislation have not been made public, it appears to be contemplated that it would address a perceived gap between coverage of the recently enacted New York legislation and the federal Trust Indenture Act, among other things. At the hearing, a representative of the Securities and Exchange Commission (SEC) indicated the possibility of that regulator potentially providing exemptive relief from the Trust Indenture Act to address the issue.

Illustrating the "tough legacy" problem vividly, in November 2020, Barclays launched a consent solicitation to amend certain of its debt securities "to make certain amendments to the method of calculating any interest payable in respect of such Series due to the expected discontinuation of LIBOR," and later reported that it had to adjourn the meeting to vote on the proposed amendments due to a lack of a quorum. Barclays subsequently announced that the amendments were not adopted because of a failure to satisfy the "Eligibility Condition" at the adjourned meeting, presumably meaning that the requisite level of votes was not obtained notwithstanding the

existence of a quorum.

Meanwhile, on April 22, 2021, the Alabama legislature, following New York's lead, sent to Governor Kay Ivey for signature a bill to address LIBOR transition.

As in prior LinkWraps, we checked in on the quarterly Citigroup Fixed Income Conference Call to see if Citi has come up with a solution to address the problematic LIBOR fallback language in some of its permanent preferreds, which *Barron's* first identified (subscription only) in January 2019. There was no news for Q4 2020, and there was no call held for Q1 2021, which is unfortunate given all the action in the last two quarters. We will hope for something more to report in our next edition.

3. LIBOR use nevertheless continues, while use of SOFR, the ARRC's recommended replacement rate, is growing glacially and meeting resistance from market participants, many of whom prefer alternatives to SOFR despite official sector disapproval and skepticism.

Against the advice of the official sector, market participants continue to use LIBOR in new transactions. The ARRC's March 2021 "Progress Report: The Transition from U.S. Dollar LIBOR," showed LIBOR use *increased* from $199 trillion at the end of 2016 to $223 trillion in 2021, with $90 trillion expected to be outstanding after the end of June 2023. Most US banks also continue to offer LIBOR as their primary or sole floating-rate business loan option, and many borrowers report lenders are not communicating with them about LIBOR alternatives.

Slow SOFR adoption continues to be a concern. After many months in which the monthly ISDA-Clarus RFR Adoption Indicator showed SOFR usage as largely flat, usage ticked up in April 2021, to 10.1% versus 8.7% for the prior month.

A number of important transactions nevertheless have been completed using SOFR as the benchmark rate in a new transaction or amending an existing transaction's terms so that it has appropriate LIBOR fallback language. In late October 2020, the Federal Farm Credit Banks Funding Corporation completed an exchange offer which added fallback language to a significant portion of its outstanding LIBOR-based bonds, with participation ranging from 53% to 100%. Also in October, Unilever and J.P. Morgan announced they had entered into a $500 million interest rate swap using SOFR, in one of the first major long-dated corporate SOFR swap transactions.

In early November 2020, in response to concerns expressed by small and mid-sized banks that SOFR was not appropriate for their needs, the Federal Reserve Board, the OCC and the FDIC issued a statement "to reiterate that they are not endorsing a specific replacement rate for LIBOR for loans" and that a "bank may use any reference rate for its loans that the bank determines to be appropriate for its funding model and customer needs."

For small and mid-sized banks, AMERIBOR continues to emerge as a leading competitor to SOFR. In November 2020, in an announcement overshadowed by IBA's announcement of the potential extension of key USD LIBOR settings until mid-2023, AMERIBOR's administrator the American Financial Exchange (AFX) disclosed a strategic alliance with Citi in which the Bank will join the AFX and also engage in position hedging using AMERIBOR futures and provide market-making in AMERIBOR interest rate swaps. In April, Zions Bancorporation announced "its intent to adopt AMERIBOR® as a replacement index for the London Inter-Bank Offered Rate (LIBOR) for the largest portion of its non-syndicated commercial loans currently indexed to LIBOR." AFX founder Dr. Richard Sandor continues to be a leading voice in the growing chorus supporting a variety of rates rather than a single replacement for LIBOR, noting in a January 2021 op-ed, "I believe a choice of benchmarks is a critical component of the transition and a healthy development for U.S. capital markets."

Another contender is the Bloomberg Short-Term Bank Yield Index (BSBY). BSBY got a boost in April 2021, when Fitch ratings announced that "Fitch believes that securities that reference BSBY meet the relevant definitions in Fitch's rating criteria for [money market funds]." Also in April, Bank of America issued a $1 billion six-month floating rate note referencing one-month BSBY.

IBA is continuing to develop its proposed ICE Bank Yield Index, for which "test settings" are now published daily.

Despite green shoots of official-sector openness to SOFR alternatives germinating only six months ago, the ARRC and others recently have changed their tone and expressed (subscription only) disfavor (subscription only) for credit-sensitive rates. ARRC Chair Tom Wipf, speaking with *Risk*, described (subscription only) as "puzzling" the interest in such rates. A few weeks later, speaking at a May 2021 SOFR Symposium hosted by the ARRC, Bank of England Governor Andrew Bailey urged market participants to "safely descend the mountain that is LIBOR" while recommending against the use of credit-sensitive alternatives to SOFR.

4. A number of key milestones in LIBOR transition have been reached.

In early October 2020, ISDA announced the intention to launch the IBOR Fallbacks Protocol and IBOR Fallbacks Supplement to ensure a smooth transition away from LIBOR should it be declared unrepresentative or cease altogether by providing SOFR as a fallback for legacy and new derivative contracts. The protocol launched later in October 2020, and came into effect on January 25, 2021. As of this writing, more than 14,000 entities have adhered to the protocol, which currently remains open for adherence indefinitely. Notwithstanding widespread adherence (subscription only) to the protocol, a number of commentators have noted that there are potential economic disadvantages to early or prompt adherence, perhaps accounting for the still significant number of institutions, particularly hedge funds, that have not yet adhered.

In January 2021, clearinghouses LCH and the CME issued (subscription only) consultations about potentially transitioning trillions of dollars of notional amount of cleared USD LIBOR-based interest-rate derivatives to SOFR "weeks prior" to the cessation of USD LIBOR in mid-2023. In April, the CME published its plans for doing so, which involve "converting IBOR cleared swaps to market standard OIS trades referencing the relevant RFR shortly prior to the corresponding Index Cessation Effective Date by (i) adjusting the floating leg by the ISDA spread to maintain duration, discounting risk as well as accruals and (ii) processing a cash adjustment to account for any changes in valuation corresponding to the conversion."

March 5, 2021 was a landmark day for LIBOR transition:

- The UK FCA announced "the future cessation or loss of representativeness of the 35 LIBOR benchmark settings currently published by" IBA, as follows:
    - All 7 Euro LIBOR settings, all 7 Swiss franc LIBOR settings, the Spot Next, 1-week, 2-month and 12-month Japanese yen LIBOR settings, the overnight, 1-week, 2-month and 12-month GBP LIBOR settings, and the 1-week and 2-month USD LIBOR settings will cease immediately after December 31, 2021; and
    - Publication of the overnight and 12-month USD LIBOR settings will cease immediately after June 30, 2023.
- The FCA also announced that after December 31, 2021, 1-month, 3-month and 6-month GBP LIBOR and 1-month, 3-month and 6-month Japanese yen LIBOR will no longer be representative and representativeness will not be restored by the FCA. Similarly, after June 30, 2023, 1-month, 3-month and 6-month USD LIBOR will no longer be representative and representativeness will not be restored by the FCA. As noted above, the FCA also will consult on the possibility of producing post-cessation versions of these nine LIBOR rates using a "changed methodology" (a/k/a "synthetic" LIBOR).
- ISDA also announced that the FCA's announcement constituted an "index cessation event" under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings, such that the fallback spread adjustment published by Bloomberg was fixed as of that date for all Euro, GBP, Swiss franc, USD and Japanese yen LIBOR settings.
- Lastly, IBA published a summary of feedback received in response to its consultations on ceasing publication of certain LIBOR settings. The complete text of non-confidential responses to the consultation also was published on the IBA website.

The following Monday, the ARRC published a statement confirming that "in its opinion the March 5, 2021 announcements by ICE Benchmarks Administration and the U.K. Financial Conduct Authority on future cessation and loss of representativeness of the LIBOR benchmarks constitutes [sic] a 'Benchmark Transition Event' with respect to all USD LIBOR settings pursuant to the ARRC recommendations regarding more robust fallback language for new issuances or originations of LIBOR floating rate notes, securitizations, syndicated business loans, and bilateral business loans." Interestingly, a substantial number of CLOs turn out to have documentation (subscription only) with LIBOR fallbacks that were triggered immediately by this announcement as opposed to the actual discontinuation of LIBOR.

5. The official sector continues to work on measures to facilitate the transition away from LIBOR.

Notwithstanding the extension of the USD LIBOR cessation timetable, the official sector continues to emphasize the need for market participants to stop issuing instruments and entering into transactions that reference USD LIBOR. Only a few days after the November 30, 2020 announcements, the FCA's Edwin Schooling Latter spoke at an ISDA webinar and stated the FCA believes it *is* possible to maintain representativeness of USD LIBOR through June 2023 and cautioned that "No one should rely on a synthetic LIBOR."

A few days after that, the Bank of England's Andrew Hauser, speaking at the Risk.net LIBOR Telethon, said, "The first priority is to break the remaining grip of LIBOR on new lending and other business as soon as possible before the end of 2021," and urged market participants to "move all your new business off LIBOR as soon as possible next year."

In January 2021, speaking at an event the day after the effective date of the ISDA protocol, the UK FCA's Schooling Latter again emphasized the need for market participants to continue their LIBOR transition work, stating "Press on with your transition." Similarly, ARRC Chair Tom Wipf wrote an op-ed (subscription only) for *Bloomberg*, stating that the achievement of the January 2021 ISDA protocol effective date and the extension of many USD LIBOR settings to mid-2023 "should not be misconstrued as a reprieve," and that "with the end of new Libor approaching, our [transition] work remains as urgent as ever."

In March 2021, Fed Vice Chair Randal Quarles, speaking at an ARRC symposium, noted the importance of halting use of LIBOR:

> [W]hat is most important this year is that firms should end new use of LIBOR. The extension of the most-used dollar LIBOR tenors should allow firms to focus in the near term on using alternative rates in new contracts and to deal more intensively with legacy contracts later. Market participants have had many years to prepare for the end of LIBOR, yet over the last few years they have actually increased use of LIBOR. Given the announcements of the FCA and the IBA, that must obviously change this year—that's just the laws of physics—and the firms we supervise should be aware of the intense supervisory focus we are placing on their transition, and especially on their plans to end issuance of new contracts by year-end.

Consistent with these messages, official sector and industry groups in both the US and the UK have continued to move ahead with transition-related measures.

In early October 2020, the Internal Revenue Service issued guidance on tax consequences of modifications to certain types of contracts to replace LIBOR or add fallbacks.

In mid-October 2020, the Financial Stability Board published a "Global Transition Roadmap for LIBOR" which "sets out clear actions for financial firms and their clients to take in order to ensure a smooth LIBOR transition."

In early November 2020, the Alternative Reference Rates Committee sent a memorandum to the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency describing preliminary findings and recommendations regarding potential regulatory considerations associated with the application of current and anticipated capital and liquidity requirements to in the context of the transition LIBOR to SOFR. Among other things, the memorandum provides the ARRC's recommendations for use of

SOFR data in various capital liquidity calculations, how to treat certain LIBOR-transition related contract amendments, and other considerations and possible effects of LIBOR transition on capital and liquidity requirements.

In April 2021, the Mortgage Bankers Association published templates for residential mortgage servicers' communications with borrowers with existing LIBOR-indexed adjustable-rate mortgages.

6. LIBOR transition officially has become a supervisory and, potentially, an enforcement issue in the U.S.

On November 30, 2020 – the same day the IBA announced its intention to consult about a mid-2023 end date for most USD LIBOR settings – the Federal Reserve Board of Governors, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) issued a statement to encourage banks to transition away from USD LIBOR as soon as practicable, stating that "the agencies believe entering into new contracts that use USD LIBOR as a reference rate after December 31, 2021, would create safety and soundness risks and will examine bank practices accordingly."

In February 2021, *Bloomberg* reported that the Federal Reserve had begun asking (subscription only) banks for specifics on their LIBOR exposures, their plans for amending LIBOR-based contracts and fallback provisions. A few weeks later, shortly after the major March 5, 2021 announcements regarding the cessation dates for LIBOR settings, the Fed issued a Supervision and Regulation Letter announcing its "guidance to assist examiners in assessing supervised firms' progress in preparing for the transition" away from LIBOR, including "six key aspects of transition efforts: (1) transition planning; (2) financial exposure measurement and risk assessment; (3) operational preparedness and controls; (4) legal contract preparedness; (5) communication; and (6) oversight." The letter concluded with a warning that "Supervised firms that are not making adequate progress in transitioning away from LIBOR could create safety and soundness risks for themselves and for the financial system. Accordingly, examiners should consider issuing supervisory findings and other supervisory actions if a firm is not ready to stop issuing LIBOR-based contracts by December 31, 2021."

As in previous years, a number of regulators, including the National Credit Union Administration and the SEC have included LIBOR transition in their enforcement and examination priorities for 2021, although interestingly FINRA did not even though it had in 2020. In January 2021, the SEC Office of Municipal Securities issued a Staff Statement on LIBOR Transition in the Municipal Securities Market, outlining muni-specific aspects of the transition that are of interest to the SEC.

Meanwhile, private civil litigation against USD LIBOR panel banks continues with two cases pending, one in federal court in New York and the other (for now) in federal court in California. The New York case is on appeal to the Second Circuit Court of Appeals, having been dismissed on the pleadings. In January 2021, the case appeared to founder (subscription only) when the original named plaintiffs withdrew from the case, but the Second Circuit ruled (subscription only) in April that new plaintiffs could be substituted. As of this writing, a date for oral argument has not been set, and the Court recently granted the parties leave to file supplemental briefs "addressing the altered posture of this appeal," so argument and decision looks to be months away. In the California case, the court conducted a hearing (subscription only) on the defendant panel banks' motion to transfer the case to New York. The court indicated it would rule without a hearing on the plaintiffs' request for a preliminary injunction barring the use of LIBOR or, in the alternative, setting it at zero pending the resolution of the case. A decision is expected in the coming months.

How Friedman Kaplan Can Help

Friedman Kaplan's LIBOR Transition Task Force is ready to:

- Help clients understand the legal, compliance, business and operations implications of LIBOR transition and develop strategies to address LIBOR-related exposures in advance of the June 30, 2023 deadline
- Help clients identify possible "friction" points and areas of dispute in legacy LIBOR-linked transactions and develop mitigation strategies, where possible, and litigate claims and disputes, where necessary
- Advise clients in connection with new and existing credit, lending and other business agreements referencing LIBOR to ensure they include appropriate provisions, including LIBOR fallbacks, and to amend other provisions so fallbacks work seamlessly

This article is not intended to provide legal advice for any specific situation, and no legal or business decision should be based on its content. If you would like Friedman Kaplan to advise you on your specific situation, please feel free to contact us.