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Fed Adopts Final Rule Under LIBOR Act

Publication of the US dollar ("USD") London Interbank Offered Rate ("LIBOR") is currently scheduled to end on June 30, 2023. For over 50 years, LIBOR has served as the benchmark for setting interest rates for most floating rate loans and debt instruments around the world. While some debt agreements have been amended to provide for a replacement benchmark in anticipation of the end of LIBOR, it is estimated that about 75% of the U.S. leveraged loan market still needs to transition away from LIBOR.[1]

To help guide the move away from LIBOR, on December 16, 2022, the Board of Governors of the Federal Reserve System (the "Board") announced that it had adopted a final rule (the "Final Rule")[2] to implement the Adjustable Interest Rate (LIBOR) Act (the "LIBOR Act").[3] The Final Rule was published in the Federal Register on January 26, 2023 and will become effective on February 27, 2023.

The LIBOR Act is intended to, among other things, establish a nationwide, uniform process for replacing references to USD LIBOR in certain existing contracts such as credit agreements and other loan documents and preclude certain litigation relating to contracts that reference USD LIBOR. The LIBOR Act contains a safe harbor protecting parties against claims, actions, and damages arising from the use of a Board-selected benchmark replacement and the implementation of benchmark conforming changes.[4]

Notably, the LIBOR Act only applies in specific circumstances, as further described below. Given that most syndicated loans include language addressing the situation where LIBOR is no longer published, so called "fallback" language (including a switch to Alternate Base Rate based on the prime or federal funds rate), it is anticipated that the LIBOR Act will not impact such deals unless the fallback language fails to ensure a transition away from LIBOR, as described below. From a borrower perspective, even if the LIBOR Act would apply, borrowers may seek to amend their agreements now if they think they can negotiate a lower credit spread adjustment. As expanded on below, the LIBOR Act locks borrowers in to the credit spread adjustments recommended by the Alternative Reference Rates Committee (a group of private debt market participants convened by the Board to assist in the transition away from LIBOR).

The Final Rule establishes a benchmark replacement for U.S. law-governed contracts that reference overnight, one-, three-, six- and twelve-month USD LIBOR and that do not provide for a clearly defined replacement benchmark. Under the Final Rule, the applicable Board-selected benchmark replacement (set out in the table below) will replace the corresponding LIBOR tenor in the following scenarios[5]:

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[1] See https://news.bloomberglaw.com/bankruptcy-law/scuffle-in-us-leveraged-loan-market-slows-down-libor-transition.

[2] Final Rule: https://www.federalregister.gov/documents/2023/01/26/2023-00213/regulations-implementing-the-adjustable-interest-rate-libor-act#:~:text=Overview%20of%20the%20Final%20Rule,clear%20and%20practicable%20benchmark%20replacements.

[3] LIBOR Act: https://uscode.house.gov/view.xhtml?path=/prelim@title12/chapter55&edition=prelim.

[4] See LIBOR Act Section 5804 and Final Rule Section 253.7.

[5] See Final Rule Section 253.3.

1. where a contract references LIBOR and contains no fallback provisions;
2. where a contract references LIBOR and contains fallback provisions that do **not** identify a specific benchmark replacement or a determining person (defined in the Final Rule as any person with the sole authority, right or obligation, including on a temporary basis, to determine a benchmark replacement, whether or not such person's authority, right or obligation is subject to any contingencies specified in the LIBOR contract or by governing law); and
3. where a contract references LIBOR and contains fallback provisions that identify a determining person, but the determining person has **not** selected a replacement.

In addition, the LIBOR Act and the Final Rule require the following references in any fallback provisions to be disregarded and deemed null and void:

- a benchmark replacement that is in any way based on any LIBOR value (except to account for the difference between LIBOR and the benchmark replacement); and
- any requirement that a person that is not the benchmark administrator (defined in the Final Rule as a person that publishes a benchmark for use by third parties) conduct a poll, survey, or inquiries for quotes or information concerning interbank lending or deposit rates.[6]

Under the Final Rule, if a determining person selects the applicable Board-selected benchmark replacement, such selection is irrevocable and shall be used in any determination of the benchmark under the applicable contract occurring on and after the "LIBOR replacement date" (defined in the Final Rule as the first London banking day after June 30, 2023, unless the Board determines that any LIBOR tenor will cease to be published or representative on a different date).[7] The Board-selected benchmark replacement shall be made by the earlier of the LIBOR replacement date and the latest date for selecting a benchmark replacement according to the terms of the applicable contract.[8]

If an agreement includes a fallback to a specific rate, for example the prime or federal funds rate, then the agreement does not fall into category 1 above.

Under category 2 above, generally, the fallback provisions are defective because they either do not actually identify a replacement or do not establish a person as having sole authority to select a replacement.

Under category 3 above, although there is a fallback provision, the determining person has not completed their task of selecting a replacement. In such events, the LIBOR Act would apply to replace LIBOR, despite there being a fallback provision in the agreement. However, note that parties to a contract may agree in writing that the contract is not subject to the LIBOR Act.[9]

With respect to LIBOR contracts that are not derivative transactions, consumer loans, Federal Housing Finance Agency regulated entity contracts, or Federal Family Education Loan Program Asset-Backed Securitizations, benchmark replacements under the Final Rule include the one-, three- and six-month credit spread adjustments (CSAs) recommended by the Alternative Reference Rates Committee and are as follows[10]:

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[6] See LIBOR Act Section 5803(b) and Final Rule Section 253.3(a)(2).

[7] See Final Rule Section 253.2.

[8] See Final Rule Section 253.3(c).

[9] See Final Rule Section 253.1(c) and LIBOR Act Section 5803(f).

[10] See Final Rule Section 253.4 and LIBOR Act Section 5802(20).

LIBOR Tenor	Replacement + CSA
Overnight	Secured Overnight Financing Rate ("SOFR") + 0.00644%
One month	One-month CME[11] Term SOFR + 0.11448%
Three month	Three-month CME Term SOFR + 0.26161%
Six month	Six-month CME Term SOFR + 0.42826%
Twelve month	Twelve-month CME Term SOFR + 0.71513%

The benchmark replacements described above will become effective on the LIBOR replacement date.

The United Kingdom's Financial Conduct Authority (the "FCA") has announced that, subject to consultation, it intends to publish a synthetic version of USD LIBOR on a non-representative basis,[12] meaning that synthetic USD LIBOR will not represent what the rate otherwise would have been if it had continued to be published. If synthetic USD LIBOR is published, it is anticipated to be available for one-, three- and six-month tenors after June 30, 2023 and through the end of September 2024. Although publication of synthetic USD LIBOR and its format are not final, it is expected to be the same as the one-, three- and six-month tenor replacements noted in the table above. Whether synthetic USD LIBOR may be used by borrowers will vary depending on the LIBOR transition language in the applicable contract and should be closely reviewed with counsel.

With less than five months until the deadline, time pressure is increasing on borrowers and lenders to ensure their loans will continue to function smoothly. All debt agreements that reference LIBOR should be reviewed with counsel and prompt action should be taken to provide for a replacement benchmark rate.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Christopher Clement (partner) at 212.701.3973 or cclement@cahill.com; Kelly Egers (counsel) at 212.701.3469 or kegers@cahill.com; or Daksha Bhatia (knowledge management specialist) at 212.701.3396 or dbhatia@cahill.com; or email publications@cahill.com.

[11] "CME Term SOFR" refers to Term SOFR as published by the Chicago Mercantile Exchange.

[12] See https://www.fca.org.uk/publications/consultation-papers/cp22-21-synthetic-us-dollar-libor#revisions.

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