THE END OF LIBOR/THE BEGINNING OF SOFR: OCTOBER 2022 UPDATE

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The official end date for USD LIBOR, June 30, 2023, is now less than nine months away. In this bulletin, we remind readers about the LIBOR discontinuation timelines, highlight some of the recent developments in the loan market with respect to SOFR, and briefly discuss the different approaches being used to replace LIBOR with SOFR in loan agreements.

1. Reminder - LIBOR Discontinuation Timelines

At the end of 2021, all tenors of EUR and CHF LIBOR, the overnight/spot next, 1-week, 2-month and 12-month GBP and JPY LIBOR tenors, and the 1-week and 2-month tenors of USD LIBOR ceased to be published. Tenors of overnight, 1, 3, 6, and 12-month USD LIBOR will continue to be published until June 30, 2023, for the purpose of legacy contracts.[1]

As of January 1, 2022, the Financial Conduct Authority (the "**FCA**") designated the 1-month, 3-month and 6-month GBP and JPY LIBOR tenors as "Article 23A" benchmarks, meaning that they are permanently unrepresentative of the market because their calculation is no longer based on panel bank submissions.[2] These tenors of LIBOR have remained available for legacy contracts, other than cleared derivatives, using a synthetic calculation methodology, and are referred to as "synthetic LIBOR".[3] The FCA determined that it was necessary to provide a temporary exception for legacy contracts (such as bonds and mortgages), given the volume of contracts linked to LIBOR that remain in the market which do not have adequate fallback provisions to transition to an alternate rate within the prescribed timeline for LIBOR's discontinuance, without the risks of substantial market disruption and consumer harm.[4]

The availability of synthetic JPY LIBOR will cease at the end of 2022. The FCA recently announced that 1-month and 6-month synthetic GBP LIBOR will be available only until March 31, 2023, after which time such tenors will permanently cease to be published.[5] Currently, the FCA is considering the responses of market participants from a consultation conducted in Q3 2022 on how and when to wind-down 3-month synthetic GBP LIBOR, and also, whether to compel the production of synthetic USD LIBOR after June 30, 2023.[6] As a reminder, the FCA has prohibited the use of synthetic LIBOR in new contracts by supervised entities.[7]

In the US, on March 15, 2022, the federal government passed the *Consolidated Appropriations Act, 2022,*[8] which includes a legislative solution for US-law governed financial contracts with maturity dates after June 30, 2023 that have no feasible way to replace LIBOR once its availability ceases.[9]

2. Recent Market Developments – SOFR

Since the Alternative Reference Rate Committee's (the "**ARRC**") formal recommendation of the forward-looking Secured Overnight Financing Rate term rates ("**Term SOFR**") developed by the CME Group, lenders have a viable risk-free alternative rate which functions similar to LIBOR[10]. On May 19, 2022, the ARRC endorsed CME's 12-month Term SOFR, with certain limitations to its scope of use.[11] As a result, the ARRC now endorses 1, 2, 3 and 12-month CME Term SOFR.[12] The ARRC recommends using Term SOFR for business loans, such as multi-lender facilities, middle market loans, and trade finance loans, where transitioning from LIBOR to overnight SOFR or SOFR average rates has been challenging.[13]

As of September 21, 2022, Refinitiv Benchmark Services (UK) Limited started publishing an "all-in" Term SOFR .[14] The rate is based on CME Term SOFR plus the ARRC's recommended spread adjustment, and is available for institutional cash products and consumer cash products.[15] The rate is published for 1, 3, 6, and 12-month tenors.[16]

The ARRC has recommended using spread adjustments for SOFR in its LIBOR fallback language for loan agreements, due to the different economics of LIBOR and SOFR.[17] For the same reason, spread adjustments are being incorporated into new SOFR issuances.[18] However, there is no single convention for spread adjustments for new SOFR loans.[19] In the US, the Loan Syndications & Trading Association reported that, in June 2022, 39% of new loans used a flat 10 bps credit spread adjustment for Term SOFR, 17% used a "market curve" credit spread adjustment (i.e. 10 bps for 1M, 15 bps for 3M, and 25 bps for 6M), and 44% used no credit spread adjustment.[20] Loans with no spread adjustment are likely embedding an adjustment into the loan margin.[21] Anecdotally, we have seen a mixed approach to spread adjustments in loan agreements in the Canadian market as well.

3. Loan Documentation

The transition away from USD LIBOR in loan agreements that use the ARRC's recommended fallback language will be triggered on the date that *all* tenors of USD LIBOR actually cease or are deemed unrepresentative, or pursuant to an early-opt in election for an alternative risk-free rate.[22] Therefore, such loan agreements will transition away from USD LIBOR on June 30, 2023 (unless pursuant to an early-opt in election).[23] Fallback language varies between documents and not all loan agreements have incorporated the ARRC's recommendations, therefore, a careful review of fallback language in loan agreements is advised. The early-opt in election has not been widely used; one of the reasons for this is that refinancing a loan using SOFR plus the

ARRC's spread adjustment is not economically attractive to borrowers at this time.[24]

During the first three calendar-quarters of this year, we have seen most new USD loan agreements include provisions for borrowings based on Term SOFR. Lenders are also using amendment opportunities, as well as renewals and re-financings, to incorporate the change from LIBOR to Term SOFR (or, less frequently, another risk-free rate). Generally, two approaches have been used to incorporate Term SOFR when amending a loan agreement. One approach involves drafting a cover amendment agreement and attaching, as an exhibit thereto, a conformed copy of the loan agreement that shows, by way of a blackline, all of the changes made to the various terms of the loan agreement to remove LIBOR and add Term SOFR provisions. Given the extent of the drafting changes required to make the switch from LIBOR to SOFR, this approach tends to be preferred, as it provides parties the convenience of being able to read the consolidated changes in a conformed, blacklined copy of the loan agreement.

The other approach involves writing out each individual amendment to the loan agreement, section by section, in a separate amendment agreement that must be read together with the main loan agreement. As the changes require the addition of numerous definitions and the replacement of all references to LIBOR throughout the loan agreement, this approach is more cumbersome and is less user-friendly for the parties, from the standpoint of ease of reading the various SOFR-related provisions. In some instances, particularly if other material amendments to the loan agreement are contemplated, the parties may agree to amend and restate the loan agreement so that all changes are consolidated in a single amended and restated loan agreement.

4. Conclusion

At this point, there should be no new LIBOR loan issuances. Lenders should be (i) familiar with alternative risk-free rates, (ii) adopting their preferred alternative risk-free rate in new loan agreements; and (iii) actively reviewing existing loan agreements that still reference LIBOR to ensure that such loan agreements incorporate appropriate fallback language or are amended to replace USD LIBOR with an alternative risk-free rate, along with a fallback mechanism.

We will continue to monitor the discontinuation of LIBOR and emerging trends with respect to alternative risk-free rates, and will continue to publish updates on notable developments.

[1] For a discussion of these extended LIBOR timelines, please refer to our bulletin: The End of LIBOR: January 2022 Update (January 2022). See also, Financial Conduct Authority, "Changes to LIBOR as of end-2021" (4 January 2022).
[2] Financial Conduct Authority, "Article 23C Benchmarks Regulation – Notice of Permitted Legacy Use By Supervised Entities" (1 January 2022).

[3] *Ibid.*
[4] *Ibid.*
[5] Financial Conduct Authority, "FCA announces decision on cessation of 1- and 6-month synthetic sterling LIBOR at end-March 2023" (29 Sept 2022).
[6] *Ibid.*
[7] *Supra*, note 2.
[8] Alternative Reference Rates Committee, "ARRC Welcomes Passage of Federal LIBOR Transition Legislation in Omnibus Spending Package" (15 March 2022).
[9] *Ibid.*
[10] For a more detailed discussion of the CME Group's Term SOFR, see our bulletin: "Start of New Term: ARRC Recommends CME Group's Term SOFR" (7 September 2021).
[11] The ARRC recommends that 12-month Term SOFR be used as part of a fallback strategy for 12-month LIBOR and in trade or receivables finance. See also, Alternative Reference Rates Committee, "ARRC Provides Update Endorsing CME 12-Month SOFR Term Rate" (19 May 2022), online.
[12] *Ibid.*
[13] *Ibid.*
[14] Refinitiv, "Refinitiv launches forward looking term rate versions of ARRC recommended fallback rates to facilitate industry transition from USD LIBOR" (21 September 2022).
[15] *Ibid*. The consumer version of all-in Term SOFR is a prototype and is expected to be produced once the ARRC sets the spread adjustments for consumer products, which will be after June 30, 2023.
[16] *Ibid.*
[17] Loan Syndications & Trading Association, "LIBOR: The Final Countdown" (29 June 2022), online.
[18] *Ibid.*
[19] *Ibid.*
[20] *Ibid.*
[21] *Ibid.*
[22] Alternative Reference Rates Committee, "ARRC Supplemental Recommendations of Hardwired Fallback Language for LIBOR Syndicated and Bilateral Business Loans" (25 March 2021).
[23] *Ibid*. The ARRC's recommended fallback language includes a provision that states that the administrative agent (in syndicated loans) or lender (in bilateral loans) may remove a tenor of LIBOR that is unavailable or unrepresentative.
[24] *Supra*, note 17.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.