THE END OF LIBOR: THE GRAND FINALE (OR IS IT?)

Posted on July 4, 2023

Categories: Insights, Publications

On June 30, 2023, all remaining tenors of USD LIBOR were published for the final time by LIBOR's administrator, the Ice Benchmark Administration Limited (the “IBA”), marking the official end of USD LIBOR and concluding years of preparation for the transition to risk-free rates. In this bulletin, we review the LIBOR discontinuation timelines, provide a summary of synthetic USD LIBOR and the Adjustable Interest Rate (LIBOR) Act (the “LIBOR Act”), and discuss implications for existing credit agreements.

1. LIBOR Discontinuation Timelines

After December 31, 2021, the initial deadline for the discontinuation of LIBOR, 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. The deadline for the discontinuation of the overnight, 1, 3, 6, and 12-month tenors of USD LIBOR was extended by 18 months for the purpose of legacy contracts and specified limited exceptions, and ceased publication on July 1, 2023.[1]

Certain tenors of GBP LIBOR and JPY LIBOR continued (and in one instance, continue) to be published for a limited period on an unrepresentative synthetic basis. The 1 and 6-month synthetic GBP LIBOR tenors ceased to be published after March 31, 2023, and the 3-month synthetic GBP LIBOR is expected to cease being published at the end of March 2024. Synthetic JPY LIBOR ceased being published at the end of 2022.

2. Synthetic USD LIBOR

On April 3, 2023, the Financial Conduct Authority (the “FCA”) announced its decision to require the IBA to publish an unrepresentative synthetic 1, 3 and 6-month USD LIBOR from July 1, 2023 until September 30, 2024.[2] The FCA determined that there remains “a small but material subset of contracts” that would be unable to transition away from USD LIBOR before July 1, 2023, and that the publication of a synthetic USD LIBOR for an additional 15 months would provide sufficient time for market participants to transition to an alternative rate,[3] and mitigate the risk to market integrity and consumer protection.[4]

Synthetic USD LIBOR will be calculated using the forward-looking Secured Overnight Financing Rate term rates (“Term SOFR”) published by CME Group Benchmark Administration plus the applicable ISDA spread adjustment for the relevant tenor. This means that synthetic USD LIBOR will be the same as the rate used in
credit agreements that have incorporated the hardwired LIBOR fallback language recommended by the Alternative Reference Rates Committee (the "ARRC"), as well as in credit agreements that use the fallback rate prescribed under the LIBOR Act (discussed in more detail below), as both use Term SOFR as the alternative rate.\[5\]

The FCA permits the use of synthetic USD LIBOR for all legacy contracts (other than cleared derivatives) that lack a mechanism to fall back to an alternative rate,\[6\] irrespective of the governing law of the contract. The FCA considered excluding US-law governed contracts, but concluded that only a small subgroup of contracts governed by US law would likely fall within the scope of its regulation and that there would be no direct legal conflict with the LIBOR Act.\[7\] It is generally expected that synthetic USD LIBOR will be used primarily in non-US law governed legacy contracts given that the LIBOR Act should apply to most US-law governed legacy contracts that do not have fallback language.\[8\]

Market participants are also reminded that synthetic USD LIBOR cannot be used in new contracts starting on July 1, 2023, which overrides any previous exemptions to new contracts that were permitted by the FCA.\[9\] To that effect, the FCA has reiterated that synthetic USD LIBOR is a temporary solution intended to facilitate an "orderly wind-down of LIBOR", and that market participants are expected to continue to take active steps to transition existing contracts that reference USD LIBOR.\[10\] While the FCA has the ability to extend the time period for synthetic USD LIBOR, they do not expect that the timeline will be extended.\[11\]

3. LIBOR Act

On March 15, 2022, the LIBOR Act was enacted by the United States Congress as part of the Consolidated Appropriations Act, 2022 to provide a uniform, nation-wide solution for replacing references to USD LIBOR in "tough legacy" contracts.\[12\] The LIBOR Act applies to US-law governed financial contracts that use overnight, 1, 3, 6 and 12-month USD LIBOR tenors, with maturity dates after June 30, 2023, and that do not have adequate fallback provisions to replace LIBOR after the "LIBOR replacement date".\[13\] Under the LIBOR Act, USD LIBOR contracts are grouped into three categories:

i. Contracts that contain fallback provisions which identify a specific benchmark replacement that is not based on USD LIBOR and that do not require any person (except a benchmark administrator) to conduct a poll, survey, or inquiries for quotes or information concerning interbank lending or deposit rates;

ii. (a) Contracts that contain no fallback provisions, and (b) contracts that have fallback provisions that do not identify a "determining person"\[14\] and that (1) only identify a benchmark replacement that is based on USD LIBOR or (2) require that a person (other than a benchmark administrator) conduct a poll, survey, or inquiries for quotes or information concerning interbank lending deposit rates; and

iii. Contracts that contain fallback provisions authorizing a determining person to determine a benchmark
The LIBOR Act provides that the contracts in the first category will transition to the benchmark replacement set out in such contracts. The contracts in the second category will fall back, on the LIBOR replacement date, to the Board of Governors of the Federal Reserve System’s (the “Board”) selected benchmark replacement, which, in the case of credit agreements, is Term SOFR plus the applicable spread adjustment. The application of the LIBOR Act to the third category of contracts depends on the determination made by the determining person. If the determining person does not select a benchmark replacement by the LIBOR replacement date or the latest date for selecting a benchmark replacement in accordance with the terms of the contract, the LIBOR Act provides that the benchmark replacement will be the Board-selected benchmark replacement (i.e. the applicable SOFR rate) plus the spread adjustment.

4. Implications for Existing Credit Agreements

Whether or not synthetic USD LIBOR or the LIBOR Act will apply to a credit agreement will depend on the specific provisions of the agreement, or the absence of any such provisions.

For all credit agreements that use the ARRC’s recommended hardwired fallback language, the transition away from USD LIBOR is triggered on the date that all tenors of USD LIBOR either cease or are deemed unrepresentative. The unrepresentativeness trigger has now occurred. Accordingly, all references to USD LIBOR throughout these credit agreements are automatically converted to Term SOFR and the applicable spread adjustment, without the need for further action by the parties to such credit agreements, other than making any conforming changes.

With respect to credit agreements that use a variant of the amendment fallback language, which does not specifically define the replacement rate and spread adjustment to be used upon the discontinuation of USD LIBOR, but rather leaves the parties to negotiate a replacement alternative rate, a careful reading of the agreement will be required to make a determination as to the applicability of synthetic USD LIBOR. For example, if a credit agreement has LIBOR fallback language based on the ARRC’s recommended amendment approach, the FCA’s announcement that USD LIBOR is unrepresentative triggers a “Benchmark Transition Event”, whereupon the Agent or Lender and the Borrower may amend the credit agreement to replace USD LIBOR. Until a replacement rate is agreed upon, a “Benchmark Unavailability Period” will commence and all USD LIBOR borrowings will be deemed to be, or converted to, the USD prime rate (i.e. ABR or USBR). The parties will not be able to fall back to synthetic USD LIBOR because synthetic USD LIBOR is unrepresentative. Synthetic USD LIBOR would also not be applicable for credit agreements that use a definition of USD LIBOR that, for instance, is based on a generic reference to the “market for interbank deposits”, as synthetic USD LIBOR is not derived from such a market.
Synthetic USD LIBOR may be applicable for credit agreements that contain workable fallbacks to USD prime or another non-LIBOR rate, and in credit agreements with fallback language that is not triggered by the unrepresentativeness of USD LIBOR. In drafting the final rule to the LIBOR Act, the Board considered the issue of how the LIBOR Act would apply if the FCA required the IBA to publish synthetic USD LIBOR. The Board concluded that contracts containing fallbacks that identify a specific alternative rate, even if they lack an express unrepresentativeness trigger, are outside of the scope of the LIBOR Act. For example, some credit agreements simply refer to the unavailability of USD LIBOR or use a definition of USD LIBOR that refers to the “London Interbank Offered Rate” available on a specified screen published by Bloomberg or Refinitiv. As USD LIBOR will continue to be published on such screens for the next 15 months (albeit on a synthetic basis), the parties to these credit agreements could rely on the publication of synthetic USD LIBOR in the interim while they negotiate a more permanent alternative rate.

As a reminder, US-law governed credit agreements that do not have fallback language would generally fall under the scope of the LIBOR Act rather than rely on synthetic USD LIBOR. In addition, we would expect that most Canadian-law governed credit agreements that reference USD LIBOR but do not have hardwired fallback language would fall back to the USD prime rate. However, depending on how USD LIBOR is defined, it is possible that such credit agreements may be able to rely on synthetic USD LIBOR.

5. Conclusion

The deadline for the discontinuation of LIBOR has now passed, although LIBOR continues to be published for certain tenors of USD and GBP on a synthetic basis. It remains to be seen whether the FCA will decide to further extend the September 2024 deadline for the discontinuation of synthetic USD LIBOR.

At this point, Lenders should be (i) familiar with alternative risk-free rates, (ii) adopting their preferred alternative risk-free rate in new credit agreements; and (iii) amending existing credit agreements that reference LIBOR and for which LIBOR fallback language has been triggered. To the extent they have not already done so, Lenders should review existing credit agreements that still reference LIBOR but do not have a fallback mechanism to determine how these agreements will fall back to an alternative risk-free rate using the tools provided by the UK and US regulators.

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

[1] For a discussion of these timelines, please refer to our bulletin: The End of LIBOR/The Beginning of SOFR: October 2022 Update.
[8] Supra, note 5.
[12] H.R.4616 – Adjustable Interest Rate (LIBOR) Act of 2021; and Federal Register, Regulations Implementing the Adjustable Interest Rate (LIBOR) Act (January 26, 2023). [LIBOR Act]
[13] “LIBOR replacement date” is defined in the LIBOR Act as the first London banking day after June 30, 2023, unless the Board determines that any LIBOR tenor will cease to be published or cease to be representative on a different date.
[14] “Determining person” is defined in the LIBOR Act as any person with the authority, right, or obligation, including on a temporary basis (as identified by the LIBOR contract or by the governing law of the LIBOR contract, as appropriate) to determine a benchmark replacement, whether or not the person’s authority, right, or obligation is subject to any contingencies specified in the LIBOR contract or by the governing law of the LIBOR contract.
[15] The Board agrees with the ARRC that different benchmark replacements may be appropriate for derivative transactions and other transactions. The ARRC recommends that Term SOFR be used only as the fallback rate for cash products, in new business loans and certain securitizations that hold underlying Term SOFR assets, and in derivatives only if these are issued to end-users to hedge cash products that reference Term SOFR. In general, derivatives will transition to SOFR compounded in arrears, which is consistent with the ISDA protocol.
[16] Supra, note 5; and Loan Syndications & Trading Association, “LIBOR Cessation: Things You Must Know” (June 8, 2023).
[18] Supra, note 12.
[19] Supra, note 5.

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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.

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