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FEDERAL RESERVE BOARD PROPOSES REGULATIONS IMPLEMENTING THE US LIBOR ACT

The Board of Governors of the US Federal Reserve System (the "**Board**") has proposed regulations ("**Proposed Regulations**", available here) to implement the Adjustable Interest Rate (LIBOR) Act, which was enacted in March 2022 as "Division U" of the Consolidated Appropriations Act of 2022 (the "**LIBOR Act**", available here). The purpose of the LIBOR Act is to provide a federal framework that mitigates risks and provides continuity for "tough legacy" contracts that reference the overnight, 1-, 3-, 6-, or 12-month tenors of U.S. dollar LIBOR ("**USD LIBOR**"). ICE Benchmark Administration ("**IBA**") has announced it will cease to publish these widely-used benchmark rates after June 30, 2023. The Board is seeking public comments on the Proposed Regulations, which should be submitted by August 29, 2022. The LIBOR Act directs the Board to adopt implementing regulations by mid-September 2022, well in advance of IBA's announced publication end date.

Key issues

- The LIBOR Act provides a federal framework for replacing USD LIBOR in legacy contracts that lack adequate fallback provisions and are governed by US law.
- The Board of Governors of the US Federal Reserve System is authorized to select benchmark replacements under the LIBOR Act and has published its proposed selections.
- The Board's proposed benchmark replacement selections vary by type of contract and could give rise to hedging mismatch issues.
- If a contract's fallback provisions depend on any determining person to select a benchmark replacement, the Board-selected benchmark replacement will replace USD LIBOR by operation of law if such determining person fails to make such a selection by the selection deadline imposed by the LIBOR Act.
- The LIBOR Act offers certain litigation safe harbors to those who select or use a Board-selected benchmark replacement to replace USD LIBOR.

WHICH REPLACEMENT BENCHMARKS IS THE BOARD PROPOSING TO SELECT IN CONNECTION WITH IMPLEMENTING THE LIBOR ACT?

The LIBOR Act authorizes the Board to select replacement benchmarks based on the Secured Overnight Financing Rate, or SOFR, for identified types of in-scope "tough legacy" contracts. The Proposed Regulations include the Board's proposed benchmark replacement selections, to which the applicable tenor spread adjustment will be added, as summarized in the below table. These selections vary by type of contract and will impact parties to in-scope contracts that will transition automatically pursuant to the LIBOR Act. In addition, by using the selected rates, market participants who actively amend their contracts may take advantage of litigation safe harbors set out in the LIBOR Act, discussed in more detail below.

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<table>
<tr><th>Type of Covered Contract</th><th>Benchmark Replacement Rate</th><th>Tenor Spread Adjustment</th></tr>
<tr><td>Derivative Transactions</td><td>"Fallback Rate (SOFR)" in ISDA's 2020 IBOR Fallbacks Protocol</td><td rowspan="3">Static tenor spread adjustment:
• 0.644 bps for overnight USD LIBOR
• 11.448 bps for 1-month USD LIBOR
• 26.161 bps for 3-month USD LIBOR
• 42.826 bps for 6-month USD LIBOR
• 71.513 bps for 12-month USD LIBOR</td></tr>
<tr><td>Cash Transactions that are neither GSE Contracts nor Consumer Loans (such as commercial credit facilities)</td><td>In place of overnight USD LIBOR: SOFR
In place of 1-, 3-, 6- and 12-month tenors of USD LIBOR: Term SOFR having the equivalent tenor</td></tr>
<tr><td>Contracts with US government sponsored enterprises (GSE Contracts) (such as contracts with Fannie Mae and Freddie Mac)</td><td>30-day Average SOFR, published by the Federal Reserve Bank of New York</td></tr>
<tr><td>Consumer Loans</td><td>In place of overnight USD LIBOR: SOFR
In place of 1-, 3-, 6- and 12-month tenors of USD LIBOR: Term SOFR having the equivalent tenor</td><td>For one year beginning on the LIBOR replacement date: a transition tenor spread adjustment providing a linear phase-in of the applicable tenor spread adjustment
After the initial one-year period: the applicable tenor spread adjustment listed above</td></tr>
</table>

While the Board's proposed selections are generally consistent with the selection of SOFR by the Alternative Reference Rates Committee ("**ARRC**") as its recommended alternative to USD LIBOR for use in cash products and the ARRC's support of the use of Term SOFR in areas where use of overnight and averages of SOFR has proven to be difficult, it raises issues for parties that have hedged USD LIBOR instruments. For example, a loan that referenced 3-month USD LIBOR would switch to 3-month Term SOFR, while a derivative transaction that hedged the loan would switch to 3-month compounded average SOFR. This is likely to result in imperfect hedging and may raise accounting issues.

It is also possible that the mandatory transition arrangements could subject parties to licensing requirements imposed by CME Group Benchmark Administration, Ltd. ("**CME**") as the publisher of Term SOFR. For example, a Category One Use License would be required to use Term SOFR as a reference in a loan, mortgage, bond, note, or money market instrument or in valuation and pricing activities, including interest rate and collateral calculations. An individual or entity that is merely a counterparty or guarantor to a transaction with the licensee of CME is not required to obtain a license. CME has currently waived related licensing fees through 2026.

Refinitiv Limited has stated that it will publish rates that equal the sum of various tenors of Term SOFR plus the applicable transition tenor spread adjustment proposed to be used during the initial one-year transition period for consumer loans. Refinitiv identifies these rates as "USD IBOR Cash Fallbacks" for consumer

products. Because calculation of the transition tenor spread adjustment may be complex, the Proposed Regulations recognize the equivalence of these Refinitiv rates. Use of any Refinitiv rates may be subject to certain licensing or other usage terms imposed by Refinitiv Limited.

Licenses are not required for the use of SOFR itself, which is produced by the Federal Reserve Bank of New York.

FOR WHICH CONTRACTS WILL A BOARD-SELECTED BENCHMARK REPLACEMENT REPLACE USD LIBOR BY OPERATION OF LAW?

Pursuant to the LIBOR Act, the Board-selected benchmark replacement will replace USD LIBOR by operation of law in any contracts, agreements, indentures, organizational documents, guarantees, mortgages, deeds of trust, leases, securities, instruments, or other obligations or assets (all of these are generally referred to as "**contracts**" in this briefing) that:

- reference the overnight, 1-, 3-, 6-, or 12-month tenors of USD LIBOR as a benchmark;
- are governed by US federal or state law; and
- the relevant contract:
  - has no fallback provisions (or only has fallback provisions that are deemed void pursuant to the LIBOR Act, as described below);
  - only has a fallback provision that identifies neither a specific benchmark replacement nor any person authorized to select a benchmark replacement (a "**determining person**"); or
  - has a fallback provision that identifies a determining person, but the determining person has failed to select a benchmark replacement by the earlier of the LIBOR replacement date (discussed below) and the latest date for selecting a benchmark replacement according to the terms of the contract.

Contractual fallback provisions that would replace USD LIBOR with any of the following are deemed void pursuant to the LIBOR Act and will be disregarded as if not included in the contract:

- a benchmark replacement that is based in any way on any USD LIBOR value, except to account for the difference between USD LIBOR and the benchmark replacement; or
- a rate that results from any person (other than the relevant benchmark administrator) conducting a poll, survey, or inquiries for quotes or information concerning interbank lending or deposit rates.

The following chart provides a high-level overview of the proposed implementation of the USD LIBOR Act based on type of fallback provision.

Type of Fallback Provision	Automatic Switch to Board-Selected Benchmark Replacement with Tenor Spread Adjustment
None	Yes
Provisions that identify neither a specific benchmark nor a determining person	Yes
Based in any way on any LIBOR value (such as last published rate), except to account for the difference between LIBOR and the benchmark replacement	Yes—These fallbacks will be disregarded as if not included & deemed null and void
Involving a poll, survey or inquiries for quotes or information concerning interbank lending or deposit rates	Yes—These fallbacks will be disregarded as if not included & deemed null and void
Amendment approach and the determining person selects the replacement benchmark in a timely manner or an alternate base rate can be determined	No
Amendment approach and the determining person fails to select a replacement benchmark in a timely manner and no alternate base rate can be determined	Yes
Hardwired approach	No

WHEN WILL THE BOARD-SELECTED BENCHMARK REPLACEMENT REPLACE USD LIBOR PURSUANT TO THE LIBOR ACT?

For covered contracts, a Board-selected benchmark replacement will replace USD LIBOR by operation of law on the earlier of the first London banking day after June 30, 2023, or any other date that the Board determines that any USD LIBOR tenor covered by the LIBOR Act will cease to be published or representative. As the Proposed Regulations do not contemplate any determinations that would result in an alternative date, the LIBOR replacement date is currently expected to be July 3, 2023.

The IBA may begin to publish a synthetic version of USD LIBOR after June 2023 to support contractual continuity for certain tough legacy contracts that are governed by non-US law. Any synthetic version of USD LIBOR would, however, no longer be representative of the underlying market and economic reality that LIBOR had been intended to measure. Because it would not be representative, publication of synthetic USD LIBOR would not impact the LIBOR replacement date for covered contracts under the LIBOR Act - those contracts will still transition to the applicable Board-selected benchmark replacement.

HOW WILL THE LIBOR ACT APPLY TO CONTRACTS WITH "AMENDMENT APPROACH" FALLBACK PROVISIONS?

For USD LIBOR contracts that contain "amendment approach" fallback language, the LIBOR Act allows, but does not require, a determining person to select the Board-selected benchmark replacement as the replacement benchmark rate. This selection by the determining person must be made by the earlier of:

- the LIBOR replacement date (as described above) and
- the latest date for selecting a benchmark replacement under the terms of the LIBOR Contract.

If the determining person selects the Board-selected benchmark replacement for a USD LIBOR contract by the replacement deadline, the Proposed Regulations would provide that such selection is irrevocable and must be used in any benchmark determinations that occur under or with respect to that contract on and after the LIBOR replacement date.

If the determining person does not select a benchmark replacement by the selection deadline, described above, the Board-selected benchmark replacement will automatically apply as of the LIBOR replacement date. This would, however, be overridden if the contract also contains alternative benchmark rate ("**ABR**") provisions (for example, the prime rate or Fed Funds). In that case, the contract would fall back to the ABR rather than the Board-selected benchmark replacement.

The Board has indicated that it is aware of potential ambiguity if a contract's fallback provisions that authorize a determining person to select a replacement benchmark are triggered only when USD LIBOR is unavailable without reference to whether USD LIBOR continues to be representative. If synthetic USD LIBOR is published after June 2023, there may be disputes as to whether the determining person is authorized to select a replacement benchmark or whether synthetic USD LIBOR should be used. The Board is considering whether its final implementing regulations should clarify whether the fallback provisions in these types of contracts should be triggered despite the availability of synthetic USD LIBOR.

The ARRC Recommended Best Practices for Completing the Transition from LIBOR, available here, indicate that a determining person should notify relevant parties of the replacement rate and any related spread adjustment methodology they anticipate selecting at least six months prior to the date that a replacement rate would become effective. This recommendation is not reflected in the LIBOR Act nor the Proposed Regulations. The Board has, however, requested public comment on this topic. Implementation of a mandatory notification requirement by regulation could present a compliance risk.

WILL THE LIBOR ACT ALTER THE TERMS OF ANY CONTRACTS WITH "HARDWIRED APPROACH" FALLBACK PROVISIONS?

For USD LIBOR contracts that contain ARRC-recommended "hardwired" fallback language or substantially similar provisions, the LIBOR Act will not alter how USD LIBOR will be replaced pursuant to the terms of the relevant contract.

If synthetic USD LIBOR is published, there may be disagreements among the parties to contracts with "hardwired approach" fallback provisions that do not refer to whether USD LIBOR continues to be representative, as with similar "amendment approach" contracts. The Board is considering whether its final implementing regulations should provide clarification as to whether the fallback provisions in these contracts should be triggered despite any publication of synthetic USD LIBOR.

WILL THE LIBOR ACT APPLY TO CONTRACTS THAT REFERENCE 1-WEEK OR 2-MONTH USD LIBOR?

The LIBOR Act does not apply to one-week and two-month USD LIBOR, which the IBA has already ceased publishing.

State law, such as New York's LIBOR transition legislation (Article 18-C "LIBOR Discontinuance" of the New York General Obligations Law, which we discuss here), is not preempted by the LIBOR Act with respect to contracts that reference one-week and two-month USD LIBOR. Accordingly, New York's LIBOR Discontinuance law provides a replacement benchmark for these tenors of USD LIBOR by operation of law for tough legacy contracts governed by New York law. As the relevant recommending body, the ARRC published recommendations, available here, for implementation of New York's law for replacement of 1-week and 2-month USD LIBOR. The static credit spread adjustments specified in the LIBOR Act are added to the Board-selected benchmark replacement, subject to the listed phase-in for consumer loans.

IS THE BOARD PROPOSING ANY BENCHMARK CONFORMING CHANGES?

The LIBOR Act gives the Board discretion to determine whether any conforming changes are necessary to address issues arising from the Board-selected benchmark replacement. Conforming changes are generally limited to technical, administrative or operational changes, alterations, or modifications that affect the implementation, administration and calculation of the Board-selected benchmark replacement. While the Proposed Regulation does not include any conforming changes, the Board has requested public comment and has left open the possibility to address conforming changes in the future.

For USD LIBOR contracts that are not consumer loans, any person who is responsible for calculating or determining any valuation, payment or other measurement based on a Board-selected benchmark replacement ("**calculating person**") may in certain circumstances implement conforming changes that have not been endorsed by the Board. To do so, the calculating person must determine that in their reasonable judgment those conforming changes are necessary or appropriate to permit the implementation, administration, and calculation of the

benchmark replacement after giving due consideration to any benchmark replacement conforming changes determined by the Board.

WHO WILL BE PROTECTED FROM LITIGATION RISK BY THE SAFE HARBOR PROVISIONS OF THE LIBOR ACT?

The LIBOR Act provides for continuity of contracts and litigation related safe harbor protections in connection with the selection or use of the applicable Board-selected benchmark replacement. The Board has acknowledged that these statutory protections will apply when parties have agreed to use the Board-selected benchmark replacement as well as when a determining person selects that replacement. Accordingly, using the Board-selected benchmark replacements will benefit entities that serve as determining persons or that are otherwise able to actively transition USD LIBOR contracts. While the Proposed Regulations do not include any clarifications or interpretations related to these protections, the Board has requested public comment on this topic.

For contracts that include "amendment approach" fallback provisions to qualify for these safe harbor protections, the selection and use of the Board-selected benchmark replacement by a determining person must:

- be irrevocable;
- be made by the earlier of either the LIBOR replacement date, or the latest date for selecting a benchmark replacement specified in the relevant LIBOR Contract; and
- be used in any determinations of the applicable benchmark under or with respect to such LIBOR Contract occurring on or after the LIBOR replacement date.

Continuity of Contracts

The LIBOR Act provides that the Board-selected benchmark replacement plus the applicable tenor spread adjustment and any benchmark replacement conforming changes constitutes:

- a commercially reasonable replacement for and a commercially substantial equivalent to USD LIBOR;
- a reasonable, comparable, or analogous rate, index, or term for USD LIBOR;
- a replacement that is based on a methodology or information that is similar or comparable to USD LIBOR;
- substantial performance by any person of any right or obligation relating to or based on USD LIBOR; and
- a replacement that has historical fluctuations that are substantially similar to those of USD LIBOR for purposes of the Truth in Lending Act and related regulations.

No Impairment

The LIBOR Act provides that neither the selection or use of the Board-selected benchmark replacement plus the applicable tenor spread adjustment to replace USD LIBOR nor the determination, implementation, or performance of conforming changes will:

- be deemed to impair or affect the right of any person to receive a payment, or to affect the amount or timing of such payment, under any USD LIBOR contract;
- have the effect of discharging or excusing performance under any USD LIBOR contract for any reason, claim, or defense, or giving any person the right to unilaterally terminate or suspend performance under any USD LIBOR contract; or
- constitute the breach, voiding or nullification of any USD LIBOR contract.

In addition, the LIBOR Act amends Section 316(b) the Trust Indenture Act of 1939 to provide that the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security will not be deemed to be impaired or affected by any change occurring by the application of Section 104 of the LIBOR Act to any indenture security.

Litigation Safe Harbors

For LIBOR contracts that switch to a Board-selected benchmark replacement by operation of law, as the result of contractual fallback language or voluntary amendment, the LIBOR Act provides that no person will be subject to any claim or cause of action in law or equity or request for equitable relief, or have liability for damages in the following three circumstances:

- "**Rate**" safe harbor related to the selection or use of a Board-selected benchmark replacement.
  This provision would protect a determining person under "amendment approach" fallback language when irrevocably selecting a Board-selected benchmark replacement only if the determining person does so by the deadline described below. This provision would also apply if a Board-selected benchmark replacement is used as the replacement benchmark as the result of the waterfall included in a "hardwired approach" fallback provision.
- "**Conforming Changes**" safe harbor related to the implementation of benchmark replacement conforming changes.
- "**Determination**" safe harbor related to the determination of benchmark replacement conforming changes to the extent that the USD LIBOR contract is not a consumer loan.

These safe harbor provisions will not, however, excuse any breach of any existing legal, regulatory, or contractual obligations to correct servicing or other ministerial errors under or with respect to any USD LIBOR contract.

Selection and Use Protections

The LIBOR Act provides that the selection or use of a Board-selected benchmark replacement or the determination, implementation, or performance of benchmark replacement conforming changes will not constitute an amendment or modification of any USD LIBOR contract. Such use will also be deemed to not prejudice, impair, or have any material or adverse effect on any person's rights, interests, or obligations with respect to a USD LIBOR contract.

CAN PARTIES CHOOSE OTHER BENCHMARK REPLACEMENTS?

US bank regulators have recognized that the use of SOFR to replace USD LIBOR is voluntary and that banks are free to choose alternative reference rates other than SOFR. In line with this guidance, the LIBOR Act provides banks, financial market participants and other contractual parties with significant flexibility to opt-out and choose alternative replacement rates. If all requisite parties agree in writing that the LIBOR Act does not apply to their USD LIBOR contract, the LIBOR Act will not alter or impair such agreement.

In addition, the LIBOR Act supports this flexibility by providing that there will be no negative inference or negative presumption regarding the validity or enforceability of any benchmark replacement (including any method for calculating, determining, or implementing an adjustment to the benchmark replacement to account for any historical differences between USD LIBOR and the benchmark replacement) that is not a Board-selected benchmark replacement, or any changes, alterations, or modifications to or with respect to a USD LIBOR contract that are not benchmark replacement conforming changes. Any such changes will, however, not benefit from the safe harbor provisions discussed above.

CONCLUSION

The LIBOR Act is intended to reduce uncertainty and adverse economic outcomes from the discontinuance of USD LIBOR by providing a federal framework for benchmark replacement in contracts that lack adequate fallback provisions and are governed by US law. The Board's proposed implementing regulations include benchmark replacement selections. These would replace USD LIBOR in covered contracts by operation of law once relevant tenors of USD LIBOR are no longer published after June 2023. The Board's proposed selections vary by type of contract, which could give rise to hedging mismatches. The Board's proposed selection of Term SOFR for a wide range of cash products may require some market participants to obtain licenses from CME to use Term SOFR if they have not already done so. While determining persons under contracts with "amendment approach" fallback provisions will have the flexibility to choose other benchmark replacements without any negative implications, the LIBOR Act offers certain safe harbor protections to entities that voluntarily replace USD LIBOR with a Board-selected replacement benchmark.

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