Cassels

Interest Rates Watch: LIBOR Transition – Occurrence of Benchmark Transition Event – Now What?

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Welcome to our *Interest Rates Watch* series, developed to provide timely updates and practical advice on developments related to interest rates and benchmarks on a regular basis. As always, we are here to help.

ICE Benchmark Administration (IBA), the administrator of LIBOR, and its regulator, the UK's Financial Conduct Authority (FCA), have announced[1] that IBA will be unable to publish LIBOR on a representative basis after certain dates and, as a result, IBA will permanently cease publishing all tenors and currencies of LIBOR on the following schedule:

- immediately following **December 31, 2021**, IBA will cease publishing 1-week and 2-month USD LIBOR and all GBP, EUR, CHF and JPY LIBOR; and
- immediately following **June 30, 2023**, IBA will cease publishing all the overnight and 1-month, 3-month, 6-month and 12-month USD LIBOR.

In preparation for the end of USD LIBOR benchmarks, the Alternative Reference Rates Committee (ARRC) in the US recommended fallback language meant to ensure that contracts will continue to be effective in the event that USD LIBOR is no longer available. In 2019, the ARRC recommended the adoption of one of two fallback approaches for credit documentation that utilize USD LIBOR:

(1) an amendment approach, which establishes a streamlined amendment process to incorporate a to-be-agreed benchmark replacement rate; or

(2) a hardwired approach, which provides for an automatic switch to a benchmark replacement rate (such rate to be based on the secured overnight financing rate (SOFR) published by the Federal Reserve Bank of New York (FRBNY), if available).

In August 2020, with more certainty around the Secured Overnight Financing Rate (SOFR) will be operationalized and with increased SOFR-based transaction volume, the ARRC recommended the exclusive use of the hardwired approach going forward.

As a result of the statements of the IBA and FCA, on March 8, 2021, the ARRC issued a statement confirming that a "Benchmark Transition Event" under the ARRC's fallback language (for both the amendment approach and hardwired approach) has occurred. We discuss some of the implications of a Benchmark Transition Event below.

Fixation of SOFR Spread Adjustments

The ARRC's hardwired fallback language utilizes a spread adjustment, which is intended to minimize the difference between USD LIBOR and the SOFR-based benchmark replacement when USD LIBOR ceases. The announcement of a Benchmark Transition Event has triggered the fixing of the fallback spread adjustments,[2] giving borrowers and lenders more information on: (a) in the case of the hardwired approach, the benchmark replacement that will become effective on cessation of USD LIBOR, to the extent parties do not agree to an alternative rate before such date and (b) in the case of the amendment approach, market convention for determining a benchmark replacement, which should be used to inform negotiations on an alternative benchmark rate. The ARRC has announced that Refinitiv, a London Stock Exchange Group business, will publish recommended spread adjustments and spread-adjusted rates on a daily basis for cash products that transition away from USD LIBOR.[3]

Impact on Credit Facilities

Any replacement rate resulting from the Benchmark Transition Event (and amendments and other actions resulting therefrom) will not take effect until the corresponding "Benchmark Replacement Date" (being, generally, the date that the applicable LIBOR currency and tenor is no longer published). For credit facilities that include the ARRC hardwired fallback language, upon cessation of publication of the applicable USD LIBOR settings, USD LIBOR will automatically be replaced with the applicable benchmark replacement calculated in accordance with the fallback language. For 1-week and 2-month USD LIBOR settings, this replacement will occur automatically from January 1, 2022, and for overnight and 1-month, 3-month, 6-month and 12-month USD LIBOR settings, this replacement will occur automatically from July 1, 2023.

In the interim, for credit facilities that include the ARRC hardwired fallback language, no amendments will be necessary to the loan agreements. However, for credit facilities that include the ARRC amendment fallback language or which do not contain any ARRC fallback language, the following is required:

- ARRC amendment fallback language – Before January 1, 2022 or July 1, 2023 (as applicable), these documents must be amended to replace USD LIBOR with a benchmark replacement, which is to be selected giving consideration to a number of factors, including any replacement rate recommended by the FRBNY and market convention. Such benchmark replacement will only take effect upon cessation of publication of the applicable USD LIBOR settings. Failure to so amend such credit facilities prior to the applicable date will result in the automatic conversion of outstanding USD LIBOR loans into US base rate loans.

- No ARRC fallback language - Before January 1, 2022 or July 1, 2023 (as applicable), these documents must be amended, failing which outstanding USD LIBOR loans will be converted into loans bearing a daily rate of interest (typically, US base rate), assuming such credit agreements have existing fallback language that provide for such conversion. To the extent there is no existing fallback language, it is unclear how existing USD LIBOR loans would be treated. However, prior to the ARRC's release of recommended USD LIBOR fallback language, the market practice for fallback language in many credit agreements was intended to only address temporary market or technological disruptions in the publication of LIBOR.

Recommendations

Given that LIBOR discontinuation clauses have transformed significantly over the past handful of years, parties to loan agreements and other transactions that use LIBOR as a reference rate should review the LIBOR discontinuation clauses to determine the implication of these announcements. Going forward, for amendments to existing paper or for new originations, parties should either (a) include robust hardwired fallback language that is substantially similar to ARRC's language with minimal deal-specific changes in any documents that use LIBOR as a reference rate, or (b) use a new reference rate (such as SOFR) plus a spread adjustment to account for the differences between SOFR and USD LIBOR. Parties to documents that utilize the ARRC's amendment fallback language, or that do not have fallback language, should begin to consider the appropriate replacement rate and ensure that documents are amended to adopt a replacement rate prior to the date upon which the applicable LIBOR setting will no longer be published (being, December 31, 2021 or June 30, 2023, as applicable). The recommended spread adjustments and spread-adjusted rates to be provided by Refinitiv will be informative in this regard. Finally, parties are discouraged from entering into new contracts that use USD LIBOR.

We will be issuing further articles relating to interest rates, including as we wait to see the spread adjustment guidance released by Refinitiv and explore the implications on ISDA documents.

We will be issuing further articles relating to interest rates. Find other articles in our Interest Rates Watch Series here.

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[1] See https://ir.theice.com/press/news-details/2021/ICE-Benchmark-Administration-Publishes-Feedback-Statement-for-the-Consultation-on-Its-Intention-to-Cease-the-Publication-of-LIBOR-Settings/default.aspx and https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf

[2] https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf

[3] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20210317-press-release-Spread-Adjustment-Vendor-Refinitiv.pdf

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This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.