Newsletter | LIBOR Transition – Issue 8

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Welcome to Greenberg Traurig's LIBOR Transition Newsletter, where we provide updates, analysis, and occasional commentary on the latest developments relating to the highly anticipated phasing-out of LIBOR.

BOTTOM LINE

On March 5, 2021, in a series of highly coordinated cross-border announcements, regulators on both sides of the Atlantic announced the future cessation of various London Interbank Offered Rates (**LIBOR**) rates. These announcements were further augmented by statements issued by various industry groups such as LSTA and ISDA as well as the LIBOR administrator. **The bottom line is that for USD LIBOR, the one-day, one-month, six-month and one-year LIBOR rates will cease publication in June 2023**. Meanwhile, the one- and two-week USD LIBOR rates will cease publication as of Dec. 31, 2021, although a synthetic rate may be available for legacy contracts after this date. Notwithstanding the June 2023 date, the U.S. banking regulators have previously advised that new financial contracts may not utilize LIBOR after Dec. 31, 2021.

Most importantly, the UK Financial Conduct Authority (FCA) announcement also triggered the calculation of the spread adjustment that will be added to the new fallback rates to approximate LIBOR. This calculation provides economic certainty to market participants as to the alternative fallback rates when LIBOR ceases to exist.

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LIBOR ANNOUNCEMENTS

In the first announcement on March 5, the FCA, regulator of ICE Benchmark Administration Limited, as LIBOR administrator, made a long-anticipated announcement in connection with the future cessation and "loss of representativeness" of 35 LIBOR benchmarks. Shortly after this announcement, the Alternative Rates Reference Committee (ARRC) in the U.S. applauded the FCA announcement, and the Federal Reserve Vice Chair of the Supervisory Board indicated that "these announcements provide a clear end-date for USD LIBOR and a clear path for the change to alternative reference rates."

These announcements were followed by the following important industry announcements:

- International Swap Derivatives Association (**ISDA**)
- Loan Syndications and Trading Association (**LSTA**)
- Loan Market Association (**LMA**)
- ICE Benchmarks Administration Limited (**ICE**)
- Bloomberg Index Services Limited (**Bloomberg**)

DISCONTINUED LIBOR RATES

Under the FCA announcement, publication of the following LIBOR settings will permanently cease on the following dates:

- immediately after Dec. 31, 2021, all seven Euro LIBOR settings, all seven Swiss Franc LIBOR settings, the Spot Next, one-week, two-month and 12-month Japanese Yen LIBOR settings, the overnight, one-week, two-month and 12-month Sterling LIBOR settings, and the one-week and two-month USD LIBOR settings, and
- immediately after June 30, 2023, the overnight and 12-month USD LIBOR settings.

In its statement, the FCA expressly articulated that it will not require panel banks to continue to submit LIBOR quotations, or require ICE to continue to publish LIBOR on the basis of panel bank submissions, after these dates. However, the FCA did leave open the possibility of continuing publication of "synthetic LIBOR" rates for the discontinued LIBOR settings, although the FCA declared that it would not compel ICE to do so. As stated by the LTSA in its own public announcement, synthetic LIBOR would be for "tough legacy contracts" and not for new loans. (*See* "Use of Synthetic LIBOR on Tough Legacy Contracts" below for a more detailed description of synthetic LIBOR.)

NON-REPRESENTATIVE LIBOR RATES

The FCA announcement stated that certain other LIBOR rates will no longer be representative of the underlying market and that representativeness will not be restored.

- immediately after Dec. 31, 2021, the one-month, three-month and six-month Japanese Yen LIBOR settings and the one-month, three-month, and six-month sterling LIBOR settings, and
- immediately after June 30, 2023, the one-month, three-month, and six-month USD LIBOR settings.

In particular, with respect to USD LIBOR, the FCA was clear to express that it will consider the case for using its powers to require the continued publication of the one-month, three-month, and six-month USD

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LIBOR settings on a synthetic basis for a further period after the end of June 2023. In so doing, the FCA will taking into account the views and evidence from the U.S. authorities and other stakeholders.

CONSEQUENCES OF FCA ANNOUNCEMENT

In its public announcement, ICE confirmed that its consultation with panel banks on LIBOR settings indicated that a majority of the LIBOR panel banks had communicated to ICE that they would not be willing to continue contributing to the applicable LIBOR settings after the dates specified above. Accordingly, ICE confirmed in its statement that it will not have the necessary inputs to publish LIBOR rates beyond the dates set forth above, and publication of LIBOR will cease on these dates. However, ICE indicated that the FCA confirmed to it that, based on undertakings received from the panel banks, it does not expect that any LIBOR settings will become unrepresentative before the above intended cessation dates for such settings. *Accordingly, market participants should feel comfortable that the dates set forth above are the earliest dates for LIBOR cessation*.

In its own public announcement, the LSTA indicated that the ARRC fallback language it has recommended for use for loans – both the amendment approach and the hardwired approach – as well as for the many other variants of fallback language in credit agreements may be triggered by this FCA announcement. However, the transition to fallback rates will not occur until LIBOR actually ceases at the end of June 2023, although a trigger event may require notice of the event by the lender or administrative agent, which would allow for the amendment process to begin. In the case of ARRC language, such an amendment could not take effect, however, until the 90-day window (or whatever number of days that parties agreed) commences on April 1, 2023. *Parties should review the terms of their loan agreement for determining the appropriate LIBOR transition date in light of this announcement*. However, the LSTA has made clear that this FCA announcement unequivocally signals "the end of LIBOR is certain and users of LIBOR need to ensure they have transitioned to alternate benchmarks in advance of the cessation dates."

ISDA followed with its own announcement and guidance declaring that the FCA announcement constitutes an Index Cessation Event for all LIBOR settings under the IBOR Supplement and Protocol previously released by ISDA. As a result, the related Index Cessation Effective Date for each LIBOR setting will occur on:

- Jan. 1, 2022, for all seven Euro LIBOR settings, all seven Swiss Franc LIBOR settings, all seven Japanese Yen LIBOR settings, and all seven Sterling LIBOR settings; and,
- July 1, 2023, for all seven USD LIBOR settings

The additional major consequence of the occurrence of an Index Cessation Event is that it also establishes the date on which the spread adjustments for the fallback rates is determined. These spread adjustments are added to the fallback rates to approximate LIBOR. As a result, the fallback spread adjustment published by Bloomberg is fixed as of the date of the FCA announcement (March 5, 2021) for all LIBOR settings.

Bloomberg confirmed its own understanding of the impact of the FCA and ISDA announcements with a public statement that under the Bloomberg IBOR Fallback Rate Adjustments Rule Book, the announcement of an Index Cessation Event by ISDA resulting from the FCA statement constitutes a "Spread Adjustment Fixing Date." The Spread Adjustment Fixing Date requires it to fix the five-year weighed average rate difference between LIBOR and SOFR. Bloomberg published the spread adjustments that it calculated as of March 5.

As noted by the LTSA, market participants now have economic certainty for the transition to risk-free rates, because the spread adjustments have now been published. However, as noted by ICE, its panel banks have expressed concern that the spread adjustment set on March 5 will not be applied until the end of June 2023 – more than two years in the future. The question is how reliable the spread adjustment will be in comparing risk-free fallback rates to LIBOR when two years of future data will be ignored.

WHAT'S NEXT FOR LIBOR TRANSITION

This series of announcements was issued to provide more economic certainty to market participants and to signal the definitive end of LIBOR, but in a long-term manner designed to minimize the market impact of transition. While new products may no longer utilize USD LIBOR after this year, this transition for legacy contracts using USD LIBOR is over two years away.

While an orderly transition is certainly welcome by the large USD LIBOR market, the question of the spread adjustments remains. Is the spread adjustment a reliable indicator of the differences in rates between LIBOR and SOFR when its calculation has been made two years before LIBOR is transitioned out? Is a single spread adjustment reliable to take into account the fluctuations due to credit-sensitive events which LIBOR measures? One third party vendor does not believe so and has indicated plans to publish a daily spread adjustment that will take into account dynamic shifts in credit sensitivity.

Additionally, hiccups in the repurchase market may cause issues in the SOFR rate that are unrelated to credit sensitivity. For example, the repurchase market suffered negative interest rates last week due to significant market shorting of U.S. Treasury securities. This situation is the opposite of what happened in September 2019, when the repurchase market had interest rates spike to double digits. Will there be further events that cause a larger divergence between LIBOR and SOFR than is indicated by the spread adjustment calculated by Bloomberg on March 5? This will be determined by any significant variations in both SOFR and LIBOR rates that may cause concerns from market participants about the fallback from a credit-sensitive rate to an overnight funding rate.

Finally, New York state incorporated language to its most recent draft budget addressing LIBOR discontinuation. In general, the proposal would amend New York's General Obligations Law by adding a new article addressing LIBOR discontinuation, in a form consistent with the ARRC's previously released proposal. The legislation would require the use of a benchmark replacement rate in any contract, security or instrument that uses LIBOR as a benchmark, in situations where a fallback provision does not exist or contains a fallback provision resulting in a benchmark replacement based on LIBOR that is not a recommended benchmark. The proposal is currently being reviewed by the New York state legislature, and it aims to provide certainty to certain "tough legacy" contracts maturing after the date of discontinuation of USD LIBOR.

USE OF SYNTHETIC LIBOR ON TOUGH LEGACY CONTRACTS

Certain of these recent announcements also referred to the previously proposed continued publication of some LIBOR rates on a synthetic basis following the relevant rate being either being discontinued or no longer representative. These synthetic rates are intended to assist with legacy financing contracts, especially the "tough legacy" contracts where migration to a replacement rate is particularly problematic.

Of particular relevance to UK regulated firms, the FCA published policy statements on March 5, 2021, regarding its proposed new powers under amendments to the UK Benchmark Regulation (**BMR**). The Financial Services Bill currently working its way through Parliament sets out these proposed amendments to the BMR, which include introducing new Articles 23A and 23D:

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- Article 23A would give the FCA the ability to designate a benchmark as an "Article 23A Benchmark," resulting in a general prohibition on the use of such benchmark or allowing its continued (limited) use subject to compliance with the FCA's requirements; and
- Article 23D would give the FCA the ability to impose requirements on the administrator of benchmarks which have been designated under Article 23A, including regarding how the benchmark is determined.

For UK-regulated firms:

- the FCA announced it will not consult on Article 23A designation of any benchmark;
- the FCA expects to exercise its powers in a manner which ensures cessation of use of each Article 23A benchmark;
- the FCA expects to exercise its Article 23D powers in a manner which (1) is "appropriate to secure cessation of an Article 23A benchmark in an orderly fashion"; and, (2) is "desirable to advance either or both of FCA's consumer protection and integrity objective";
- the use of synthetic rates on new transactions is expected to be prohibited by the BMR as amended by the Financial Services Bill; and
- the existence of "tough legacy" contracts and the sophistication of the parties to them will be among the considerations of how the FCA exercises its Article 23D powers, noting the above statement that the FCA expects to exercise such powers in a manner which secures the cessation of the designated benchmark.

It therefore appears that regulated firms should not assume LIBOR will continue to be available for use even on "tough legacy" contracts.

Read previous editions of GT's LIBOR Transition Newsletter.

Authors

This GT Newsletter was prepared by:

- Sylvie A. Durham | +1 212.801.6923 | durhams@gtlaw.com
- Oscar Stephens | +1 212.801.9202 | stephenso@gtlaw.com
- Graeme McLellan | +44 (0) 203.349.8729 | mclellang@gtlaw.com
- Arleen A. Nand | +1 612.259.9711 | nanda@gtlaw.com

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