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LIBOR Transition Efforts Continue in the U.S. with SOFR as the Leading Recommended Alternative Reference Rate

As previously reported, the LIBOR settings for one-week and two-month USD LIBOR tenors will cease being representative after December 31, 2021.[1] This cessation is expect to have less of an impact because these tenors are not as widely used as others.[2] All other settings—including one-month, three-month, and six-month USD LIBORs—are scheduled to cease being representative after June 30, 2023. In the U.S., transition efforts continue. We provide an overview of those recent developments and guidance, all of which emphasize that market participants should be evaluating the appropriate alternative to LIBOR for the products they offer. The Secured Overnight Funding Rate (SOFR) published by the Federal Reserve Bank of New York has repeatedly been endorsed as one of those alternatives to LIBOR.

SOFR and Other Alternative Rates

The Alternative Reference Rates Committee ("ARRC"), convened by the Federal Reserve Board and the Federal Reserve Bank of New York, has identified SOFR as "the rate that represents best practices for use in certain new USD derivatives and other financial contracts."[3] SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities in the repurchase, or "repo," market.[4] Among other differences from LIBOR, SOFR (i) is considered a "'near risk-free rate'" (i.e., it lacks a credit risk component) because it is secured by U.S. Treasuries; and (ii) at least until recently lacked a forward-looking component such as LIBOR's one-week and one-, two-, three-, six- and twelve-month tenors.[5]

At the moment, there are a range of other proposed alternative reference rates in the U.S.: the Bloomberg Short-Term Bank Yield Index (BSBY), the US Dollar ICE Bank Yield Index (IBYI), the Across-the-Curve Credit Spread Index (AXI), and Ameribor. All of these proposed alternatives attempt to fill the credit risk and forward-looking gaps that some believe exist in SOFR.

The choice among the existing alternative rates has been a frequent subject of remarks by regulatory heads, both in their official and personal capacities. In a speech by Randal K. Quarles, a member of the Board of Governors of the Federal Reserve System and then Vice Chair for Supervision, he noted that the Federal Reserve, the Office of the Comptroller of the Currency ("OCC")

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1 *LIBOR Cessation: FCA Announcement on the End of LIBOR Triggers ISDA's Spread Adjustment Fixing Date*, March 5, 2021, Paul, Weiss, available here.

2 *See ICE LIBOR Feedback Statement on Consultation on Potential Cessation*, ICE Benchmark Administration, Mar. 5, 2021, available here.

3 *The Alternative Reference Rates Committee: Transition from LIBOR*, Federal Reserve Bank of New York, available here.

4 *See Secured Overnight Financing Rate Data*, Federal Reserve Bank of New York, available here.

5 *See SEC Issues Statement Highlighting Risks Regarding LIBOR Transition*, Paul, Weiss, July 18, 2019, available here.

and the FDIC had not endorsed a specific replacement rate with respect to loans.[6] He stressed, however, that "it is critical that capital markets and derivatives market transition to SOFR."[7]

Acting Comptroller of the Currency Michael J. Hsu also addressed replacements for LIBOR in his remarks made at an ARRC symposium on October 26, 2021.[8] Acting Comptroller Hsu counseled that any replacement rates "should be robust."[9] He referred to the Joint Statement on Managing Libor Transition that was issued by the OCC, together with four other federal financial institution regulatory agencies and state bank and state credit union regulators, which reiterated the regulatory agencies' expectation that banks demonstrate that their chosen alternative rates are "appropriate for their risk profile, risk management capabilities, customer and funding needs, and operational capabilities."[10] Acting Comptroller Hsu explained that the International Organization of Securities Commissions had noted that SOFR was a "robust rate suitable for use in most products" so that the "OCC supervisory efforts would initially focus on non-SOFR rates."[11]

On September 20, 2021, SEC Chairman Gary Gensler, in remarks he made in a personal capacity before the ARRC's SOFR Symposium, discussed the alternative reference rates available.[12] He affirmed his support for the ARRC's choice of SOFR as the preferred alternative rate, especially in comparison to BSBY.[13] Chairman Gensler also urged institutions not to put off the LIBOR transition and warned that he does not foresee an extension of the cessation of LIBOR beyond December 31, 2021.[14] This was consistent with remarks Chairman Gensler made before the Financial Stability Oversight Council on June 11, 2021, where he also stated his preference for SOFR over BSBY and noted that he believes BSBY "has many of the same flaws as LIBOR."[15]

Recent Activity Relating to Alternative Reference Rates

Legislative

On December 8, 2021, the House of Representatives passed the Adjustable Interest Rate (LIBOR) Act of 2021 (H.R. 4616) (the "Act"), which provides for a statutory replacement benchmark rate for contracts that use LIBOR as a benchmark and do not contain any fallback mechanism independent of LIBOR.[16] Pursuant to the Act, SOFR becomes the new benchmark rate by operation of law for any such contract. The Act establishes a safe harbor from litigation for claims arising out of or related to the use of SOFR as the recommended benchmark replacement. The Act makes clear that it should not be construed to disfavor the use of any benchmark on a prospective basis.

The Act also attempts to forestall challenges that it is impairing contracts. It provides that the discontinuance of LIBOR and the automatic statutory transition to a replacement rate neither impairs or affects the rights of a party to receive payment under such contracts, nor allows a party to discharge their performance obligations or to declare a breach of contract. It amends the Trust Indenture Act of 1939 to state that the "the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security shall not be deemed to be impaired or affected" by application of the Act to any indenture security.

Finally, the Act contains a preemption clause expressly stating that it supersedes "any and all laws, statutes, rules, regulation, or standards of any State the District of Columbia, or any territory or possession of the United States, insofar as they provide for the

6 Randal K. Quarles, *Goodbye to All That: The End of LIBOR*, The Structured Finance Association Conference, Las Vegas, Nevada, Oct. 5, 2021, available here.

7 *Id.*

8 Michael J. Hsu, *Remarks at the Alternative Reference Rates Committee (ARRC) Symposium*, Oct. 26, 2021, available here.

9 *Id.*

10 *Id.*; *see also Joint Statement on Managing the LIBOR Transition*, Oct. 20, 2021, available here.

11 Hsu, *supra* note 7; *see also* International Organization Of Securities Commissions, *Statement on Credit Sensitive Rates*, Sept. 8, 2021, available here.

12 Chairman Gary Gensler, *Remarks Before the Alternative Reference Rates Committee's SOFR Symposium*, Sept. 20, 2021, available here.

13 *Id.*

14 *SOFR Symposium: The Final Year, Session 5*, Sept. 20, 2021, recording available here.

15 Chairman Gary Gensler, *Prepared Remarks Before the Financial Stability Oversight Council*, June 11, 2021, available here.

16 *See* Adjustable Interest Rate (LIBOR) Act of 2021, H.R. 4616, 117th Cong. (2021), available here.

selection or use of a Benchmark Replacement or related conforming changes." Similar state legislation passed in New York and Alabama may be mooted if the Act becomes law.[17]

The Act was supported by both parties in Congress as well as senior federal regulatory officials and industry groups.[18] The Act's sponsor, Brad Sherman, the Democratic Representative for California's 30th District and Chairman of the House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, has urged the Senate to move quickly to pass the bill.[19]

Regulatory

On December 7, 2021, the Consumer Financial Protection Bureau ("CFPB") released a final rule that amends Regulation Z, which implemented the Truth in Lending Act, aimed at addressing cessation of LIBOR for both closed-end (e.g., home mortgage) and open-end (e.g., home equity line of credit) products.[20] The rule, which mostly becomes effective April 2022, establishes requirements for the selection of replacement indices for existing LIBOR-linked consumer loans. Although the rule does not mandate the use of SOFR as the alternative rate, it identifies SOFR as a comparable rate for closed-end products and states that for open-end products, the CFPB has determined that ARRC's recommended spread-adjusted indices based on SOFR for consumer products to replace the one-month, three-month, or six-month USD LIBOR index "have historical fluctuations that are substantially similar to those of the LIBOR indices that they are intended to replace."[21] The CFPB reserved judgment, however, on a SOFR-based spread-adjusted replacement index to replace the one-year USD LIBOR until it obtained additional information.[22] In a statement accompanying the release of the rule, Director Rohit Chopra explained that the rule "helps set the guardrails for an orderly transition away from the LIBOR index" and noted that "[i]n most circumstances, lenders will replace the LIBOR index with new indices based on the SOFR (Secured Overnight Financing Rate) or the prime rate SOFR."[23]

Working Groups

On July 29, 2021, the ARRC formally recommended CME Group's forward-looking SOFR, representing a significant milestone in the transition from LIBOR.[24] This recommendation clears the way for use of the CME Term SOFR Rates in new and existing financial products. Following the announcement, the ARRC Chairman Tom Wipf urged "everyone with LIBOR exposures to immediately take action and base their new contracts on forms of SOFR," as the end of 2021 fast approaches.[25] According to the ARRC, the formal recommendation of the SOFR Term Rate provides market participants with the final tool necessary to successfully transition away from LIBOR.

In conjunction with the recommendation, the ARRC also released conventions and best practices for use of SOFR term rates. As a general principle, the ARRC recommends SOFR for all new contracts and recommends that market participants use overnight SOFR and SOFR averages, especially for floating rate notes, mortgages, student loans, and most securitizations.[26] The ARRC further expressed its support for use of the SOFR Term Rate in areas where use of overnight and averages of SOFR has proven challenging, including multi-lender facilities, middle market loans, and trade finance loans.[27] In contrast, the ARRC has expressly noted its lack of support for the use of the SOFR Term Rate in the vast majority of the derivative markets. The ARRC explained that use of the SOFR Term Rate should be limited to end-user facing derivatives that seek to hedge cash products that reference

17 *See Governor Cuomo Introduces Proposed New York Legislation on LIBOR Replacement*, Paul, Weiss, updated April 6, 2021, available here; LIBOR Discontinuance and Replacement Act of 2021, Ala. Code § 5-28-1, Ala. Leg., available here.

18 *See* 167 CONG. REC. H747986 (daily ed. Dec. 8, 2021), available here.

19 *Id.* (statement of Rep. Sherman).

20 *See Facilitating the LIBOR Transition (Regulation Z)*, CFPB, Dec. 7, 2021 (codified at 12 C.F.R. § 1026), available here.

21 *Id.*

22 *Id.*

23 *See* Rohit Chopra, *Statement of Director Rohit Chopra on the LIBOR Transition Rule*, Dec. 7, 2021, available here.

24 *See ARRC Formally Recommends Term SOFR*, Alternative Reference Rates Committee, Paul, Weiss, July 29, 2021, available here.

25 *Id.*

26 *ARRC Best Practice Recommendation Related to Scope of Use of the Term Rate*, Alternative Reference Rates Committee, August 27, 2021, available here.

27 *Id.*

the same rate.[28] This "limitation is intended to avoid use that is not in proportion to, or materially detracts from, the depth of transactions in the underlying derivatives markets that are essential to the construction of the SOFR Term Rate over time."[29]

Market participants in the syndicated loan market have begun making SOFR-based loans, and to facilitate the use of SOFR, the Loan Syndications & Trading Association, an industry platform of participants in the syndicated lending market, published concept loan documents for the incorporation of Term SOFR and Daily Simple Risk Free Rate Multicurrency, Daily Simple SOFR / Daily Compounded SOFR (Compound the Balance), Daily Compounded SOFR (Compound the Rate), and Term SOFR.[30]

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28 *Id.*

29 *Id.*

30 *Updated LIBOR Transition Documents*, LSTA, Dec. 17, 2021, available here.

The time has finally come when some of the USD LIBOR tenors will cease being representative. Market participants now have, however, a range of alternative reference rates available to them. Additional guidance and thoughts about these alternative rates will continue as the market prepares for the June 20, 2023 deadline. We will continue to monitor developments.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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