BANKING
REGULATION

Libor transition: the final leg of the marathon

Lary Stromfeld of **Cadwalader, Wickersham & Taft** outlines the challenges of transitioning legacy contracts away from US dollar Libor

Since Andrew Bailey, then CEO of the UK's Financial Conduct Authority (FCA), fired the starting gun in **July 2017**, regulators and market participants around the world have been planning for the end of LIBOR, which will now occur in less than 10 weeks. For many, this is the final leg of a marathon that has included many legal, economic, and operational hurdles. For others, this will be an all-out sprint to the finish line. This article lays out some of the many considerations to meet the challenge of transitioning legacy contracts away from US dollar Libor.

What will happen to LIBOR after June 30?

Before discussing what happens to legacy contracts that reference Libor, we must first understand what will happen to Libor itself. Libor is administered by ICE Benchmark Administrator (IBA), which is regulated by the FCA. LIBOR has historically been compiled by IBA on the basis of a panel of banks providing quotes that are intended to be representative of interest rate markets. The FCA and IBA announced that these banks will stop providing quotes after **June 30 2023**. However, to facilitate an orderly transition of a "small but material subset" of Libor contracts, the FCA has compelled IBA to continue publishing a "synthetic" version of USD Libor, in one, three and six month tenors, for a limited period. "Synthetic" Libor will not be a "representative" rate. Rather, it will be based on **CME term SOFR** plus a fixed spread adjustment. "SOFR" is the secured overnight financing rate, which has been recommended as the replacement for **USD Libor**.

Contract assessment

If not already completed, every financial institution must immediately analyse what will happen to its outstanding Libor contracts after June 30. For each contract, this review should focus on trigger events, fallback rates, and governing law. Determining the appropriate transition plan for each contract will be based on a number of considerations. Does the contract clearly contemplate that Libor may cease to be published or no longer be representative? If not, has the event triggering the replacement of LIBOR under the contract occurred? Does the availability of "synthetic" Libor after June 30 affect the interpretation of these provisions? If the trigger event has occurred, does the contract identify a specific benchmark replacement or method for determining the replacement?

Some contracts, such as those that incorporate recommended fallback language published by the Alternative Reference Rates Committee (ARRC), provide a "waterfall" of replacements based, among other things, on whether a particular version of SOFR has been recommended by the ARRC at the time of the trigger. Other contracts (generally, loans and consumer contracts) do not specify a replacement index, but instead authorize someone to select a replacement index. Other legacy contracts include provisions that require transitioning to a specific alternative, such as prime, the Fed funds rate, or an alternative base rate. Some contracts contain no fallback provisions or fall back to a Libor-based rate, such as "last available LIBOR." Contracts in this last category that are governed by US law are subject to the federal **Adjustable Interest Rate (LIBOR) Act**, which will automatically apply a statutory replacement rate based on SOFR.

Contract implementation or remediation

Once the terms of a contract are understood, steps must be taken to either implement the relevant provisions or remediate unworkable provisions.

For contracts with a "waterfall" of replacement rates, determine which rate will apply. For those that incorporate the ARRC's hard-wired fallback language, the ARRC has published a statement of recommended replacement rates for various categories of **contracts**. Where the contract gives a party the right to select the replacement, consideration should be given to whether to choose the SOFR-based benchmark sanctioned by the federal LIBOR Act in order to get the benefit of its safe harbor protection against litigation. Many syndicated loans provide for a streamlined consent process to amend the applicable benchmark. In each case, the operative provisions of the fallback will need to be implemented according to the terms of the contract.

Even contracts that transition to a replacement rate automatically by operation of the federal LIBOR Act could require certain additional changes to administer the new rate. For example, the source for obtaining each reset of the benchmark and the "business day" definition are likely to be different for SOFR versus Libor.

From a legal risk perspective, the safest way to transition to a post-Libor world is to seek consensual amendments to all legacy contracts so that they no longer reference Libor at all. For non-cleared swap contracts, that process is easy: adhere to the 2020 **IBOR Fallback Protocol** and urge counterparties to do the same. For other contract types, amending deals can be labour intensive and expensive, but it is still the best way to minimise dispute risk. Keep in mind that with June 30 just around the corner, there will be a growing wave of demand for amendments. Don't get caught in that *tsunami*.

Communication

Timely and accurate communication is a critical element of a smooth transition. Financial institutions should ensure that the details of impending rate replacements and any associated contract changes are known by all appropriate parties. Although the Federal Reserve did not impose a notice requirement under the LIBOR Act, other regulations (in the case of consumer products), contract terms, and good business practices likely do. Early notice helps minimize confusion and dispute risk by allowing time to resolve any disagreements before June 30. The ARRC has recommended that financial institutions provide at least six months' notice prior to the effective date of any **changes**. With even less time remaining until Libor ceases, the sooner notice is provided the better.

For securities with a CUSIP number, one tool that can help with communicating changes is the enhanced Legal Notice System (LENS), which is now live. The system was designed by the Depository Trust & Clearing Corporation (DTCC), the ARRC, and others to facilitate the communication of replacement **indices**.

Logistics and operational challenges

Finally, financial institutions need to prepare for the technical, administrative, and operational changes required to successfully transition from Libor. The pervasive use of Libor over many decades means that it became embedded in policies, systems and programs at all levels of an organisation. One commentator has compared Libor transition to rewriting every cookbook to remove all references to "salt." The challenge should not be underestimated.

Conclusion

We are in the final stretch of the Libor marathon. The time to act is now. By analysing legacy contracts, implementing or remediating relevant provisions, communicating with counterparties, and implementing needed logistical changes, financial institutions can minimise legal, operational and reputational risks when they reach the June 30 finish line.