FRIED FRANK

To Our Clients and Friends

Memorandum

November 20, 2020

USD LIBOR Transition Timeline in Question Following IBA & FCA Statements

A degree of uncertainty arose this week concerning the widely anticipated year-end 2021 demise of USD LIBOR. On Wednesday, November 18, ICE Benchmark Administration Limited ("IBA"), the administrator for LIBOR, announced plans to consult on its intention to cease publication of all tenors of GBP, EUR, CHF and JPY LIBOR settings after December 31, 2021. Concerning USD LIBOR, however, IBA merely noted that discussions with the U.K.'s Financial Conduct Authority (the "FCA") and other official sector bodies and panel banks are continuing, with future announcements to come after those discussions conclude.[1] Wednesday's statement by IBA coincided with a related FCA consultation announcement addressing, among other topics, the FCA's potential new approach to ensuring an orderly wind down of USD LIBOR through the use of new powers to be granted under amendments to the Benchmarks Regulation that are contained in the currently pending U.K. Financial Services Bill.[2]

The IBA and FCA announcements include disclaimers discouraging speculation over any potential impact on the current timeline for transitioning away from USD LIBOR. Nevertheless, some commentators have suggested that the announcements indicate that official sector and panel bank discussions on the transition are lagging behind those regarding LIBOR rates for other major currencies and that, therefore, the transition from USD LIBOR to a widely-accepted replacement rate – most likely the Secured Overnight Financing Rate ("SOFR") – may get pushed out beyond December 31, 2021, which is the date after which panel banks could no longer be compelled to make USD LIBOR submissions.[3]

The IBA and FCA announcements, in light of other legislative and industry-led developments, raise questions about market preparedness for the expected transition away from USD LIBOR. On October 28, 2020, the New York State Senate introduced SB S9070, which seeks to amend the state's uniform commercial code in relation to the effect of a LIBOR discontinuance event on contracts, securities, and other agreements subject to New York law (the "New York Senate Bill").

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1 *See* Intercontinental Exchange*, ICE Benchmark Administration to Consult On Its Intention to Cease the Publication of GBP, EUR, CHF and JPY LIBOR*, Nov. 18, 2020, https://ir.theice.com/press/news-details/2020/ICE-Benchmark-Administration-to-Consult-On-Its-Intention-to-Cease-the-Publication-of-GBP-EUR-CHF-and-JPY-LIBOR/default.aspx.

2 The FCA's intended policy approach, which would be relevant to USD LIBOR settings, would seek to leverage the FCA's new authority to require the publication of a "synthetic" USD LIBOR rate to (i) address so-called "tough legacy" contracts, which cannot be practicably transitioned away from the referenced benchmark rate through bilateral negotiations, and (ii) protect and preserve market integrity. *See* Financial Conduct Authority, *FCA consults on new benchmarks powers*, Nov. 18, 2020, https://www.fca.org.uk/news/statements/fca-consults-on-new-benchmark-powers.

3 In response to the IBA and FCA announcements, the International Swaps and Derivatives Association, Inc. ("ISDA") also released a statement confirming that such announcements did not constitute an index cessation event under the IBOR Fallbacks Supplement or the ISDA 2020 IBOR Fallbacks Protocol, nor would such announcements trigger fallbacks under the 2018 ISDA Benchmarks Supplement or related protocol. *See* ISDA, *ISDA Statement on IBA and UK FCA Announcements on LIBOR* Consultation, Nov. 18, 2020, https://www.isda.org/a/OONTE/ISDA-Statement-on-IBA-and-FCA-Announcements-on-LIBOR-Consultation.pdf.

Specifically, the New York Senate Bill would (i) enact provisions prohibiting parties from refusing to perform contractual obligations or declaring a breach of contract as a result of the discontinuance of USD LIBOR or the use of a replacement rate, (ii) establish that the LIBOR replacement rate is a commercially reasonable substitute for and a commercially substantial equivalent to USD LIBOR, and (iii) provide a safe harbor from litigation for the use of a benchmark replacement rate selected or recommended by the Federal Reserve Board, the Federal Reserve Bank of New York, or the Alternative Reference Rates Committee (or any of their successors).[4] The New York Senate Bill and a companion proposal in the New York State Assembly, AB A11098, remain in committee and are not expected to receive a vote until first quarter 2021 at the earliest.

At the federal level, the U.S. House of Representatives is working on draft legislation that reportedly would largely replicate the New York Senate Bill but expressly preempt state law with respect to USD LIBOR replacement in all contracts, securities and instruments (including contracts with respect to commercial transactions).

Although a consensus appears to have formed around the choice of SOFR as the replacement rate for USD LIBOR, and current legislative proposals appear to contemplate this consensus, not all market participants are in agreement as to the methodology for adjusting for the inherent differences between USD LIBOR and SOFR.[5] In particular, certain regional banks have expressed support for the use of a credit sensitive rate/dynamic credit spread to SOFR for use in the commercial lending/line of credit markets to help better align banks' replacement lending benchmark rates with their costs of funds. An industry working group convened to advocate for the use of a credit sensitive rate, the "Credit Sensitivity Group," is in ongoing discussions with the official sector to address these banks' concerns regarding the macroeconomic, safety and soundness, and financial stability implications of decoupling borrowing and lending rates.[6] These discussions have yet to produce a broadly acceptable viable alternative to SOFR in these markets; however, concerns have been raised that the potential adoption by some lenders of alternative rates such as the ICE Bank Yield Index or Ameribor (both of which incorporate a credit spread) may further complicate any timely transition from USD LIBOR to SOFR, including by stymieing efforts to develop liquidity in SOFR cash and derivatives markets by December 31, 2021.

We will continue to monitor and report on developments in this area.

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4 *See* https://legislation.nysenate.gov/pdf/bills/2019/S9070.

5 The inherent differences between USD LIBOR and SOFR can be categorized broadly into three buckets: (1) differences in term structure (*i.e.*, LIBOR utilizes forward term rates with tenors ranging from overnight to one year, whereas SOFR is a backward-looking overnight rate), (2) differences in the incorporation of a credit spread (*i.e.*, LIBOR reflects panel bank credit risk, whereas SOFR is a nearly risk-free rate), and (3) differences in the construction of the rate (*i.e.*, LIBOR is based on panel bank submissions, actual market transactions, and expert judgment, whereas SOFR is based solely on actual market transactions).

6 *See* Federal Reserve Bank of New York, *Transition from LIBOR: Credit Sensitivity Group Workshops*, Last updated Nov. 19, 2020, https://www.newyorkfed.org/newsevents/events/markets/2020/0225-2020.

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