

Termination of U.S. LIBOR Tenors Postponed Until June 30, 2023

by Joseph Lynyak, Erin Bryan, and Betsy Sanders Parker

On November 30, 2020, the ICE Benchmark Administration Limited (commonly referred to as “ICE”) announced its plan to extend the date that most U.S. LIBOR values would cease being computed and announced from December 31, 2021 to June 30, 2023.¹ This extension—which reflects approximately an 18-month reprieve from the death of U.S. LIBOR—is a welcome delay that will allow most creditors employing a U.S. LIBOR tenor as an index for variable rate credit instruments and other agreements to properly prepare for the termination of U.S. LIBOR. Further, the additional time will permit creditors, in many cases, to substitute a U.S. LIBOR index with another index through normal portfolio run-off or the renewal or amendment of credit agreements.

In its announcement, ICE indicated its plan that five U.S. LIBOR tenors would now expire on June 30, 2023, while two other U.S. LIBOR tenors would expire on the original termination date, December 31, 2021:

U.S LIBOR Tenors Expiring June 30, 2023:

- Overnight U.S. LIBOR
- 1-Month U.S. LIBOR
- 3-Month U.S. LIBOR
- 6-Month U.S. LIBOR, and
- 1-Year U.S. LIBOR

U.S. LIBOR Tenors Expiring December 31, 2021:

- 1-Week U.S. LIBOR, and
- 2-Month U.S. LIBOR

The 1-Year U.S. LIBOR and 3-Month U.S. LIBOR indices are reportedly the most frequently used index values for commercial and consumer lending transactions.

Related People

- Joseph Lynyak
- Erin Bryan
- Betsy Sanders Parker

Related Capabilities

- Banking & Financial Institutions
- Consumer Financial Services

The Role of Governmental Entities and Private Parties in the Replacement Debate

On November 17, 2014, the Federal Reserve Board convened the Alternative Reference Rates Committee (the “ARRC”) to identify an alternative, transaction-based reference rate to replace the various LIBOR indices. The ARRC has been principally focused on achieving a solution among large swaps and derivatives participants in order to avoid disruption to the \$800 *trillion* swaps and derivatives markets upon the termination of LIBOR.² Since its inception, the ARRC has issued numerous studies and analyses regarding the use of its recommended replacement index—the Secured Overnight Financing Rate (the “SOFR”)—but has paid seemingly little attention to the effect (and usefulness) that the use of the SOFR would have on legacy smaller-sized credit transactions and residential mortgage instruments.

As part of its deliberations, the ARRC has issued numerous consultative documents recommending replacement language and “trigger” provisions which, upon occurrence, would authorize one or several counterparties to substitute the designated LIBOR index for another substitute index (with the SOFR being the clear favorite for swaps and derivatives instruments).³ However, that focus on the use of SOFR for swaps and derivatives has given short shrift to indices that might be of value in other contexts, including the CMT⁴, certain COFI indices⁵ and Wall Street Journal Prime, among others.⁶

In that regard, in January 2019, ICE announced a possible replacement for the U.S. LIBOR indices—the U.S. Dollar ICE Bank Yield Index. ICE has since published several updates, including an update in May of 2020 that supports the view that the proposed index is intended “specifically as a potential replacement for LIBOR for U.S. dollar lending activity,” and is intended to be “a forward-looking, credit-sensitive benchmark.”⁷ Of particular note is that the data reported by ICE for this proposed replacement index mirrors the U.S. LIBOR Index virtually identically both in respect of movement and valuation. As such, the U.S. Dollar ICE Bank Yield Index may offer advantages that some of the competing index candidates lack, such as greater comparability to the U.S. LIBOR.

The Impact of a Delayed Termination Date for U.S. LIBOR

In conjunction with several European regulatory agencies, the date of December 31, 2021, was originally selected by the ARRC as the latest date that the calculation of the various values of the LIBOR index would cease. However, with the planned extension by ICE of the cessation date for most U.S. LIBOR tenors, creditors must consider the implications of that extended termination date (*i.e.*, June 30, 2023), including the following:

A. For Most Credit Instruments a Replacement Trigger Event is Now Postponed.

While perhaps obvious on its face, contractual limitations in instruments such as bi-lateral credit agreements that employ a U.S. LIBOR index whose termination has been delayed will now not permit a replacement process to occur until June of 2023. Stated another way, a creditor may not have the contractual authority to initiate an index

replacement process until June, 2023. From a planning perspective, however, this may enable creditors additional time to prepare operational systems for substituting and calculating a selected replacement index for a U.S. LIBOR tenor.⁸

B. Creditors Should Take Advantage of the Extension of Time to Modify or Replace Index Replacement Language in Credit Documents.

One of the lessons learned in the LIBOR replacement debate is that one size does not fit all in regard to the selection of fallback language for replacing U.S. LIBOR. For example, while the ARRC has drafted comprehensive language for large commercial transactions, several pages of fallback provisions are simply unacceptable for a three or four page simple commercial promissory note.

In that regard, a lender should analyze its current replacement language and amend its credit documents on a go-forward basis, as well as draft supplemental language to be utilized when the opportunity for a loan modification presents itself (e.g., a requested loan modification or extension by a borrower).

C. Creditors Should Carefully Select a Replacement Index.

Although there may appear to be insurmountable pressure being applied by the ARRC and the Federal Reserve to adopt the SOFR as a replacement index, on November 6, 2020, the federal banking regulators issued a notice that clarified that categories of commercial and consumer transactions may warrant the use of another replacement index—and that banks and other lenders are free to select an alternative index (other than the SOFR).⁹ On November 30, 2020, the federal banking agencies acknowledged the delay by ICE in the termination of U.S. LIBOR tenors, and encouraged regulated institutions to utilize that time to complete preparations for a fulsome replacement process.¹⁰

D. Evaluate Litigation Risk.

There is general agreement among commentators that the LIBOR substitution process may create litigation risk—at least to the extent that a substituted index results in additional interest expense or loss of income on the part of borrowers, note holders and investors. Creditors should undertake a careful analysis to identify and mitigate that litigation risk—which the extended termination date for most U.S. LIBOR tenors has now provided.

For example, due to the fact that the SOFR is a secured index, the value of the SOFR historically is well below that of U.S. LIBOR tenors. In the instance in which a credit agreement does not permit the adjustment of a margin to accompany the replacement of a U.S. LIBOR index, the substitution of the SOFR for a U.S. LIBOR tenor may create legal risk, as well as loss of expected revenue.

* * *

Please note that this Alert is a summary of numerous legal issues that relate to the LIBOR replacement process that is currently underway. Additional questions and comments may be directed to Dorsey attorneys.

¹ <https://ir.theice.com/press/news-details/2020/ICE-Benchmark-Administration-to-Consult-on-Its-Intention-to-Cease-the-Publication-of-One-Week-and-Two-Month-USD-LIBOR-Settings-at-End-December-2021-and-the-Remaining-USD-LIBOR-Settings-at-End-June-2023/default.aspx>. At the same time, ICE announced its intention to cease issuing GBP, EUR, CHF and JPY LIBOR indices and values on December 31, 2021.

² The swaps and derivatives markets using U.S. LIBOR are estimated to exceed \$200 trillion in size. See, <https://www.sec.gov/spotlight/fixed-income-advisory-committee/arrc-faqs-041519.pdf>.

³ See, <https://www.newyorkfed.org/arrc/publications>.

⁴ See, <https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield>.

⁵ See, <https://www.fhlbdc.com/products-services/advances/>.

⁶ See, <https://www.wsj.com/market-data/bonds/moneyrates>.

⁷ See, https://www.theice.com/publicdocs/IBA_US_Dollar_ICE_Bank_Yield_Index_Fourth_Update.pdf.

⁸ While beyond the scope of this Alert, despite the ARRC's enthusiastic support for the use of the SOFR, while several tenors of the SOFR have been announced, few have actually become operational (presenting creditors with concerns whether the initial termination date for U.S. LIBOR was practical).

⁹ See Federal Reserve Supervision and Regulation Letter 20-25 (November 6, 2020); OCC Bulletin 2020-98 (November 6, 2020); and FDIC Financial Institution Letter 104-2020 (November 6, 2020).

¹⁰ <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf>.