LIBOR Phase-Out: What the Countdown to 2021 Means for Lenders

Patience Kalu Omokhodion, Cassels Brock & Blackwell LLP
Thomas C. Baxter Jr., Sullivan & Cromwell LLP
Joseph T. Lynyak III, Dorsey & Whitney LLP
Matthew E. Thompson, Finastra

Materials Summary Abstract

The London Interbank Offered Rate (LIBOR) is a global benchmark interest rate, which is calculated in five difference currencies. US Dollar LIBOR alone is referenced in approximately $200 trillion of outstanding financial products. The LIBOR benchmark is used for nearly all financial products, including commercial, consumer, and mortgage loan products. Numerous outstanding loan transactions have maturities well into the future. The problem is that LIBOR has become less reliable and trustworthy, and it may not exist after 2021.

LIBOR is determined daily based on the representations of certain large, international banks regarding what they believe they would have to pay to borrow unsecured funds from each other on the London interbank lending market. US Dollar LIBOR is calculated from an average of 18 bank submissions after excluding the four highest and lowest submissions. Since LIBOR is not set by the cost of funds that banks actually pay, it was always susceptible to manipulation by stakeholders and traders. And when widespread LIBOR manipulation was discovered, regulators assessed billions of dollars of penalties and fines against institutions and individuals. While panel banks have continued to participate in the LIBOR survey at the insistence of regulators, that voluntary agreement to sustain LIBOR will cease at the end of 2021, when LIBOR will either disappear entirely or become unreliable.

In response to this potentiality, the Federal Reserve Board and the Federal Reserve Bank of New York (New York Fed) created the Alternative Reference Rate Committee (ARRC) “to identify a set of alternative reference interest rates that are more firmly based on transactions from a robust underlying market and that comply with emerging standards,” as well as to establish best practices for contract quality, and to develop and create an implementation plan. In 2017, the ARRC announced that the Secured Overnight Financing Rate has been chosen as the recommended primary replacement rate for LIBOR.1 As it is described by the New York Fed:

The Secured Overnight Financing Rate (SOFR) is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. The SOFR includes all trades in the Broad General Collateral Rate plus

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1 The New York Fed publishes two other alternative reference rates in addition to the SOFR – the Broad General Collateral Rate (BGCR) and the Tri-Party General Collateral Rate (TGCR).
bilateral Treasury repurchase agreement (repo) transactions cleared through the Delivery-versus-Payment (DVP) service offered by the Fixed income Clearing Corporation (FICC), which is filtered to remove a portion of the transactions considered “specials”.

The SOFR is calculated as a volume-weighted median of the transactional-level tri-party repo data collected from the Bank of New York Mellon as well as GCF Repo transaction data and data on the bilateral Treasury repo transactions cleared through FICC’s DVP service, which are obtained from DTCC Solutions LLC, an affiliate of the Depository Trust & Clearing Corporation. Each business day, the New York Fed publishes the SOFR on the New York Fed website at approximately 8:00 a.m.

The analysis of LIBOR substitution for bilateral commercial and consumer lending may be significantly different from the financial markets approach and authority. And whereas the ARRC is working on model fallback language for securitizations and bilateral business loans, LIBOR-based consumer loans continue to be originated without any consensus index substitution language. The scale of the problem is significant. The ARRC estimates that $1.2 trillion of consumer mortgages were tied to LIBOR as of 2010 and that approximately 800 billion will remain in 2025. Whether and how lenders may select a substitute index and adjust the margin in compliance with consumer loan regulations must be analyzed.
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March 28, 2019

Joseph T. Lynyak, Thomas Baxter and Patience Kalu Omokhodion
Agenda

• Background
• Asset classes
• Timetable for phase out
• Substitution alternatives
• Stakeholders/participants
• Financial market concerns
• Consumer concerns
• Litigation concerns
BACKGROUND
Background
General Description

• **LIBOR** stands for the London Interbank Offered Rate
  – It is a global floating benchmark interest rate
  – LIBOR is calculated daily in 5 currencies:
    • USD, EUR, GBP, JPY, and CHF
  – LIBOR is used for short term lending between banks and is reported in 7 maturities:
    • Overnight, one week, and 1, 2, 3, 6 and 12 months

• Administered by the **ICE Benchmark Administration** (IBA or ICE)
  – Independent UK subsidiary of Intercontinental Exchange

• LIBOR determined each day based on the representations of panel banks as to the rates at which they could each borrow on the London interbank lending market
Background
Calculations & Use

• USD LIBOR is calculated by ICE:
  – Based on an average of 18 bank submissions
  – the 4 highest and lowest submissions are excluded
  – Global banks submit their estimates to Thomson Reuteurs every day by 11am GMT
  – LIBOR is then published

• Base Rate
  – Approximately $200 trillion in outstanding transactions reference USD LIBOR
    • 95% consist of derivatives
    • 5% consist of consumer and commercial loans
Background
Problems

• LIBOR scandals
  – “Rate Rigging” – LIBOR has allegedly been manipulated by stakeholders and traders
  – Investigations by regulators in multiple jurisdictions, including by the US Department of Justice
  – Punishments
    • Fines - Total U.S. and EU fines exceed $9 Billion
    • Criminal charges against individuals

• Reliability gap
  – Criticism of central banks and failure to address the scandals
  – Reduction in actual LIBOR-based unsecured borrowings by large banks
  – Expert judgments rather than actual reported transactions now being relied upon
Background

Reformation and Phase Out

• Reform - Strengthened Regulation
  – 2012 legislation to create the UK’s Financial Conduct Authority ("FCA")
  – Transfer of LIBOR to ICE – an independent agency

• Phase Out - In 2014 numerous international regulators and stakeholder groups began work on establishing alternative reference rates
  – US Approach
    • Federal Reserve Board created the “Alternative Reference Rates Committee” or “ARRC” to identify alternative, transaction based reference rate to replace LIBOR
    • In June of 2017 the ARRC identified the “Secured Overnight Financing Rate” (“SOFR”) as its preferred substitute to USD LIBOR
      – A broad overnight rate based on repo financing rates
      – Unlike LIBOR—a secured rate index
  – UK Approach
    • In July 2017 the FCA announced that it will no longer compel or persuade banks to submit to LIBOR panels after the end of 2021
    • The FCA has indicated that panel banks may voluntarily provide LIBOR data until the end of 2021
ASSET CLASSES
# Asset Classes Affected

## Table 1: Estimated USD LIBOR Market Footprint by Asset Class

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Volume (Trillions USD)</th>
<th>Share Maturing By:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>End 2021</td>
<td>End 2025</td>
</tr>
<tr>
<td><strong>Over-the-Counter Derivatives</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Interest rate swaps</td>
<td>81</td>
<td>66%</td>
<td>88%</td>
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<tr>
<td>Forward rate agreements</td>
<td>34</td>
<td>100%</td>
<td>100%</td>
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<tr>
<td>Interest rate options</td>
<td>12</td>
<td>65%</td>
<td>68%</td>
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<tr>
<td>Cross currency swaps</td>
<td>18</td>
<td>88%</td>
<td>93%</td>
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<tr>
<td><strong>Exchange Traded Derivatives</strong></td>
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<td></td>
</tr>
<tr>
<td>Interest rate options</td>
<td>34</td>
<td>99%</td>
<td>100%</td>
</tr>
<tr>
<td>Interest rate futures</td>
<td>11</td>
<td>99%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Business Loans</strong></td>
<td></td>
<td></td>
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<tr>
<td>Syndicated loans</td>
<td>1.5</td>
<td>83%</td>
<td>100%</td>
</tr>
<tr>
<td>Nonsyndicated business loans</td>
<td>0.8</td>
<td>86%</td>
<td>97%</td>
</tr>
<tr>
<td>Nonsyndicated CRE/Commercial mortgages</td>
<td>1.1</td>
<td>83%</td>
<td>94%</td>
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<tr>
<td><strong>Consumer Loans</strong></td>
<td></td>
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<td></td>
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<tr>
<td>Retail mortgages</td>
<td>1.2</td>
<td>57%</td>
<td>82%</td>
</tr>
<tr>
<td>Other Consumer loans</td>
<td>0.1</td>
<td></td>
<td></td>
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<tr>
<td><strong>Bonds</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floating/Variable Rate Notes</td>
<td>1.8</td>
<td>84%</td>
<td>93%</td>
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<tr>
<td><strong>Securities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage-backed Securities (incl. CMOs)</td>
<td>1.0</td>
<td>57%</td>
<td>81%</td>
</tr>
<tr>
<td>Collateralized loan obligations</td>
<td>0.4</td>
<td>26%</td>
<td>72%</td>
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<tr>
<td>Asset-backed securities</td>
<td>0.2</td>
<td>55%</td>
<td>78%</td>
</tr>
<tr>
<td>Collateralized debt obligations</td>
<td>0.2</td>
<td>48%</td>
<td>73%</td>
</tr>
<tr>
<td><strong>Total USD LIBOR Exposure:</strong></td>
<td>199</td>
<td>82%</td>
<td>92%</td>
</tr>
</tbody>
</table>

1 Source: Federal Reserve staff calculations, BIS, Bloomberg, CME, DTCC, Federal Reserve Financial Accounts of the United States, G.19, Shared National Credit, and Y-14 data, and JPMorgan Chase. Data are gross notional exposures as of year-end 2016. 2 The figures for syndicated and corporate business loans do not include drawn lines. Nonsyndicated business loans exclude CRE/commercial mortgage loans. 3 Estimated maturities based on historical pre-payment rates.
TIMETABLE FOR 2021 PHASE OUT
Timetable

Transition from U.S. Dollar LIBOR – Timeline

The Alternative Reference Rates Committee (ARRC) was originally convened in November 2014. Significant progress has been made to date.

- **May** – CME launched SOFR futures
- **Apr.** – New York Fed/OFR began publishing SOFR
- **May** – ARRC selected SOFR as its recommended alternative to USD LIBOR
- **Mar.** – ARRC’s second report published
- **Jun.** – FCA Bailey said panel banks will not be compelled to submit to LIBOR past 2021
- ** Jul.** – ARRC recomposed with expanded membership
- **Sept.** – ARRC issued consultations on fallback language for FRNs and syndicated loans
- **Dec. 2018** – ARRC issued consultations on fallback language for bilateral loans, securitizations*
- **1H 2019** – Continue to build liquidity in SOFR markets

ARRC is seeking to produce an indicative SOFR-based term reference rate based on futures data to help promote market familiarity with the term rate.

ARRC expects to produce final recommendations for safer contract language in FRNs, business loans, and securitizations.

*ARRC expects to consult on fallback language for other cash products

**As of 1/30/19**
SUBSTITUTION ALTERNATIVES
Substitution Alternatives

- **Secured Overnight Financing Rate ("SOFR")**
  - Overnight, nearly “risk free” rate that is correlated with other money market rates
  - Fully transaction based, reflecting broad measure of overnight US Treasury repurchase ("Repo") financing transactions (tri-party repo, FICC GCF repo, FICC bilateral treasury repo)
  - Encompasses robust underlying market with over $650 billion in daily transactions
  - NY Fed proposes to use a volume-weighted median as the central tendency measure for SOFR and to publish summary statistics to accompany the daily publication of the rate
  - SOFR is published each business day at 8:00 AM EST
Other Substitution Alternatives

- **SONIA—Reformed Sterling Overnight Index Average**
  - Based on unsecured overnight transactions negotiated bilaterally and arranged with brokers

- **TONAR—Tokyo Overnight Average Rate**
  - Based on transactions executed in the unsecured overnight call rate market

- **SARON—Swiss Average Rate Overnight**
  - Based on secured transactions in the interbank overnight Repo market

- **EONIA—Euro Over Night Index Average**
  - Based upon average interest rate at which a selection of European banks lend one another in euros with a maturity of one day

- The ICE Benchmark Administration has announced its effort to calculate and announce a modified LIBOR
STAKEHOLDERS AND PARTICIPANTS
Stakeholders/Participants

- ARRC
- FRB
- ISDA -
  - working on fallback language for derivatives contracts
- Federal Prudential Bank Regulators
- FASB
- IOSCO
- British Regulatory Authorities
  - Prudential Regulation Authority
  - Financial Conduct Authority
  - ICE Benchmark Administration
  - Financial Stability Board
FINANCIAL MARKET CONCERNS
1. **UK - Andrew Bailey, the Chief Executive of the FCA, has been in the lead.**
   - In the summer of 2017, he warned that at the end of 2021 the Financial Conduct Authority would stop pressuring banks to submit rates so that the benchmark administrator could determine LIBOR rates.
   - In December of 2018, Mr. Bailey was even more pointed and quotable. He said, “I hope it is already clear that the discontinuation of LIBOR should not be considered a remote probability “black swan” event. Firms should treat it as something that will happen and which they must be prepared for.”

2. **USA - William Dudley, past President of the Federal Reserve Bank of New York, has been even more directed in his comments to the legal profession.** In May of 2018, President Dudley said that the failure to develop “fallback contract language in the even that LIBOR ceases to be published” would constitute “an unacceptable risk.”
Focused Attention: Four Core Concepts

1. **Trigger.** The event that requires the replacement of one index with another.

2. **Fallback.** Assuming that a triggering event occurs, what the instrument provides will happen with respect to the replacement of one Index with another. What happens when an agreement is silent as to the triggering event?
   - **Lender concerns**
   - **Borrower concerns**

3. **Margin.** Usually expressed in terms of basis points, the spread over (or under) the Index which produces the interest rate that the debtor is required to pay from time to time.

4. **Index.** This is the reference rate that is used to set the base rate for an adjustable rate instrument, which will adjust from time to time, and that determines in part, what the debtor will pay. For purposes of this program, the Index will be LIBOR.
Specific Illustration: Fannie Mae Form Adjustable Rate Note*

**ADJUSTABLE RATE NOTE**

(LIBOR One-Year Index (As Published In The Wall Street Journal)—Rate Caps)

THIS NOTE CONTAINS PROVISIONS ALLOWING FOR CHANGES IN MY INTEREST RATE AND MY MONTHLY PAYMENT. THIS NOTE LIMITS THE AMOUNT MY INTEREST RATE CAN CHANGE AT ANY ONE TIME AND THE MINIMUM AND MAXIMUM RATES I MUST PAY.

4. INTEREST RATE AND MONTHLY PAYMENT CHANGES

(A) Change Dates

The interest rate I will pay may change on the first day of _________________, ______, and on that day every 12th month thereafter. Each date on which my interest rate could change is called a “Change Date.”

(B) The Index

Beginning with the first Change Date, my interest rate will be based on an Index. The “Index” is the average of interbank offered rates for one-year U.S. dollar-denominated deposits in the London market (“LIBOR”), as published in The Wall Street Journal. The most recent Index value available as of the date 45 days before each Change Date is called the “Current Index,” provided that if the Current Index is less than zero, then the Current Index will be deemed to be zero for purposes of calculating my interest rate.

If the Index is no longer available, the Note Holder will choose a new index which is based upon comparable information. The Note Holder will give me notice of this choice.

(C) Calculation of Changes

Before each Change Date, the Note Holder will calculate my new interest rate by adding a percentage points (\(\text{Margin} \)) to the Current Index. The Note Holder will then round the result of this addition to the nearest one-eighth of one percentage point (0.125%). Subject to the limits stated in Section 4(D) below, this rounded amount will be my new interest rate until the next Change Date.

The Note Holder will then determine the amount of the monthly payment that would be sufficient to repay the unpaid principal that I am expected to owe at the Change Date in full on the Maturity Date at my new interest rate in substantially equal payments. The result of this calculation will be the new amount of my monthly payment.

* Used with the permission of Fannie Mae, whose contribution to this program is gratefully acknowledged.
Cessation Analysis: Basic Concepts

1. When a triggering event occurs, LIBOR as the Index gets replaced by a new Index. The ARRC has recommended SOFR as the successor rate for U.S. dollar contracts.

2. LIBOR is a rate that contains a credit component. SOFR, which is based upon secured financings where the security consists of U.S. Treasury and agency securities, is considered a risk-free rate.

3. Because of the difference in nature, the ARRC has recognized the importance of a so-called “spread adjustment”. The spread adjustment would adjust for credit risk premia embedded in LIBOR, and for a number of other differences between LIBOR and SOFR. See ARRC Consultation, “Regarding More Robust LIBOR Fallback Contract Language For new Issuances of LIBOR Floating Rate Notes” (Sept. 24, 2018); ARRC Consultation, “Frequently Asked Questions” (Oct. 29, 2018).
Other Key Issues: Legacy Instruments

1. What does “no longer available” mean?
   A. Perhaps the Wall Street Journal no longer publishes LIBOR, but LIBOR is nevertheless still produced by an Administrator. Is LIBOR “no longer available”?
   B. Andrew Bailey referred to pressure on contributors. What if you get to the point where there are only 2 contributors? “Zombie LIBOR” is a term used to refer to a rate that is not backed by a minimum number of real transactions.
   C. Many new instruments are more descriptive with respect to what will constitute a trigger event.
Other Key Issues: Legacy Instruments (Cont’d)

2. With respect to the fallback Index, what is an Index “based upon comparable information”?

   A. Is SOFR comparable to LIBOR, given that SOFR is a risk-free rate but LIBOR is derived with implicit credit premia?

   B. Can we make the rates “comparable” with a spread adjustment?

   C. What about the process of setting the spread adjustment? This obviously could be a source for disputes between debtor and creditor. Can the spread adjustment be set exclusively by the creditor? Should there be an “independent” calculation agent?
Illustration: Risk Free Rate vs. LIBOR

1-Year Treasury CMT is a risk-free rate. LIBOR and Prime have a credit component.
Illustration: Volatility of SOFR vs. LIBOR

80 basis point disparity in December 2018
Observations Regarding Move From Rate Containing Credit Risk Premia to Risk Free Rate

1. A simple move from LIBOR to SOFR would likely result in a move to a lower Index.

2. If Margin remains constant, the debtor will have a lower financing cost, meaning this change would result in a debtor gain equivalent to the value adjustment.

3. Alternatively, if the instrument (i.e., contract terms) permits, we could adjust the Margin to avoid the transfer of value from creditor to debtor.

4. Drafting Consideration: In new instruments, use language permitting this kind of spread adjustment.
TRANSITIONING –
successors and market disruption

• "LIBOR" means, with respect to any LIBOR Advance for any Interest Period:
  
  • the rate of interest set by ICE Benchmark Administration Limited (or any successor to, or substitute for, such service, providing rate quotations comparable to those currently provided by ICE Benchmark Administration Limited) applicable to U.S. Dollar deposits in the London interbank market (as published by any service selected by the Lender that has been nominated by ICE Benchmark Administration Limited (or any successor thereto) as an authorized information vendor for the purpose of displaying such rates), as determined by the Lender at approximately 11:55 a.m., London time, on the date that is two Business Days prior to the first day of such Interest Period and having a maturity equal to such Interest Period; or
  
  • in the event that no such rate is available to the Lender, then LIBOR for the relevant Interest Period shall be the rate per annum determined by the Lender to be the rate at which deposits in U.S. Dollars, in the approximate amount of the applicable LIBOR Advance and for a period equal to such Interest Period, would be offered to the Lender by major banks in the London interbank market at approximately 11:00 a.m., London time, on the date that is two Business Days prior to the first day of such Interest Period;

  provided that, in no event shall LIBOR for any Interest Period be less than zero percent per annum.
TRANSITIONING – successors and market disruption

- What is a “successor to, or substitute for, such service”?
- What does “no such rate is available to the Lender” mean?
- What power does the Lender have to determine or select a replacement service?
TRANSITIONING – successors and market disruption

- Market Disruption Language

LIBOR. If the Lender determines at any time that:

a) by reason of circumstances affecting the London interbank market, adequate and fair means do not exist for ascertaining the rate of interest with respect to, or deposits are not available in sufficient amounts in the ordinary course of business at the rate determined hereunder to fund, a requested LIBOR Advance during an Interest Period selected by the Borrower;

b) the making or continuance of an Advance as a LIBOR Advance has been made impracticable by the occurrence of an event which materially adversely affects the London interbank market generally; or

c) LIBOR does not adequately reflect the cost of funds to the Lender of U.S. Dollar deposits in the London interbank market for an Interest Period selected by the Borrower;

d) the Lender will promptly notify the Borrower of such determination. From and after delivery of such notice by the Lender, the Lender shall not be obligated to provide LIBOR Advances hereunder until such time as the Lender determines in good faith that the circumstances giving rise to such situation no longer exist and gives notice thereof to the Borrower, and any further Drawdown Request, Conversion Notice or Rollover Notice requesting a LIBOR Advance shall be deemed to be a Drawdown Request or Conversion Notice, as applicable, requesting a U.S. Base Rate Advance in the same aggregate principal amount.
Discontinuation of LIBOR language

(a) If at any time the Lender determines (which determination shall be conclusive, absent manifest error) that:

• The circumstances described in Section [MARKET DISRUPTION CLAUSE (LIBOR)] have arisen and such circumstances are unlikely to be temporary, or that the circumstances described in Section [MARKET DISRUPTION CLAUSE (LIBOR)] have not arisen, but either (x) the applicable supervisor or administrator of LIBOR, or (y) a Governmental Authority having jurisdiction over the Lender, has made a public statement identifying a specific date after which LIBOR shall no longer be used for determining interest rates for loans (either such date, a "LIBOR Discontinuation Date"); or

• A rate other than LIBOR has become a widely recognized benchmark rate for newly originated loans denominated in U.S. Dollars in the Canadian market;

• then the Lender and the Borrower shall negotiate in good faith to select a replacement index for LIBOR and make adjustments to the Applicable Margin and other, related, amendments to this Agreement such that, to the extent practicable, the all-in interest rate paid by the Borrower under this Agreement based on the replacement index will be substantially equivalent to the all-in interest rate applicable to LIBOR Advances made hereunder prior to LIBOR’s replacement.

(b) Upon an agreement being reached between the Lender and the Borrower pursuant to clause (a) above, the Lender and the Borrower shall enter into an amendment to this Agreement that gives effect to the replacement reference rate of interest, adjustments to the Applicable Margin and such other related amendments as may be appropriate in the discretion of the Lender for the implementation and administration of U.S. Dollar loans bearing interest calculated with reference to the replacement index. Notwithstanding anything to the contrary in this Agreement or any other Loan Document (including Section [AMENDMENTS SECTION NUMBER]), such amendment shall become effective at [[INSERT TIME AND DATE] OR [INSERT MECHANISM FOR SYNDICATED FACILITY]].

(c) Selection of the replacement index, adjustments to the Applicable Margin, and all other related amendments to this Agreement contemplated by Section [1.01] shall give due consideration to the prevailing market practice for: (i) determining a rate of interest applicable to newly originated U.S. dollar loans made in Canada at such time, and (ii) transitioning existing loans from LIBOR-based interest rates to loans bearing interest calculated with reference to the new reference rate.

(d) Until an amendment reflecting the transition to a new reference rate becomes effective as contemplated by this Section [1.01], each Drawdown, Conversion or Rollover of a LIBOR Advance shall continue to bear interest calculated with reference to LIBOR; provided that if the Lender determines (which determination shall be conclusive, absent manifest error) that a LIBOR Discontinuation Date has occurred, then following the LIBOR Discontinuation Date, all LIBOR Advances shall automatically be converted to U.S. Base Rate Advances until such time as an amending agreement adopting a new reference rate of interest becomes effective as contemplated by this Section [1.01].
TRANSITIONING – successors and market disruption

• Market Disruption Language
  – Lender/Agent friendly
    • Bilateral loan gives the Lender the ability to determine rate
    • Provides possibility of ceasing to make or continue to make LIBOR loans
  – Borrower would insist on “reasonableness” qualifiers
  – What does “adequate and fair” mean?
  – Concrete next steps for Lenders and expectation for borrower
    • Lender to provide notice to borrower of determination
    • Conversion mechanism that floating rate loans are converted to fixed rate loans (we use the US Base Rate (i.e. USD commercial loans made in Canada)).
CONSUMER CONCERNS
Consumer Concerns

• Consumer – defined
• ARRC estimates $1.2 trillion of consumer mortgages as of 2021
  – Approximately $800 billion will remain outstanding as of 2025
  – LIBOR-based consumer loans continue to be originated
  – The analysis for LIBOR index substitution may be significantly different than the methodology to be employed by the financial markets
• Certainty – consumers need to be able to calculate their interest costs
An Exemplar—the ARRC Bilateral Business Loan Substitution Language

ARRC DRAFT AMENDMENT APPROACH FALLBACK LANGUAGE FOR NEW ORIGINATIONS OF LIBOR BILATERAL BUSINESS LOANS

Effect of Benchmark Discontinuance Event

(a) Notwithstanding anything to the contrary in this Agreement or any other Loan Document, at or promptly after a Benchmark Transition Determination, the Lender pursuant to clause (b) of this Section titled “Effect of Benchmark Discontinuance Event” may amend this Agreement to replace LIBOR with an alternate benchmark rate (which may include Term SOFR, to the extent publicly available quotes of Term SOFR exist at the relevant time), including any Replacement Benchmark Spread, in each case giving due consideration to [any evolving or then existing convention for similar U.S. dollar denominated credit facilities for such alternative benchmarks and adjustments or] any selection, endorsement or recommendation by the Relevant Governmental Body with respect to such facilities (any such proposed rate, together with the Replacement Benchmark Spread, a “Replacement Benchmark”). Such Replacement Benchmark shall be applied in a manner consistent with market practice or, to the extent such market practice is not administratively feasible for the Lender, in a manner as otherwise reasonably determined by the Lender; provided that in no event shall such Replacement Benchmark be less than zero for purposes of this Agreement.
(b) Any such amendment with respect to an event under clause (1) or (2) of the definition of “Benchmark Transition Determination” shall become effective upon the Lender’s determination to seek such amendment and the passage of [five (5)][ten (10)] Business Days following the receipt of such amendment by the Borrower specifying the terms of such amendment including, without limitation, the Replacement Benchmark, (including the Replacement Benchmark Spread), unless, prior to the passage of such time, the Borrower has delivered written notice to Lender that it does not accept such amendment. No replacement of LIBOR with a Replacement Benchmark pursuant to this Section titled “Effect of Benchmark Discontinuance Event” shall occur (i) prior to the applicable Benchmark Transition Start Date or (ii) prior to the effective date for such replacement, if any, specified in such amendment.

(c) The Lender will promptly notify Borrower of the occurrence of any Benchmark Unavailability Period. The Borrower may revoke any request for a Eurodollar Borrowing of, conversion to or continuation of Eurodollar Loans to be made, converted or continued during any Benchmark Unavailability Period and, if no such revocation is timely sent by the Borrower, the Borrower will be deemed to have converted any such request into a request for a Borrowing of or conversion to ABR Loans (subject to the next sentence). During any Benchmark Unavailability Period, the LIBO Rate component shall not be used in any determination of ABR.

(d) The Lender shall have the right upon making a Benchmark Transition Determination [from time to time] to make any Replacement Benchmark Conforming Changes and, notwithstanding any other provision of this Agreement to the contrary, any amendment[s] implementing such Replacement Benchmark Conforming Changes shall become effective without any further action or consent of the Borrower.
“(e) As used in this Section titled “Effect of Benchmark Discontinuance Event”:

Benchmark Discontinuance Event” means the occurrence of one or more of the following events with respect to LIBOR:

(1) a public statement or publication of information by or on behalf of the administrator of LIBOR announcing that such administrator has ceased or will cease to provide LIBOR, permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide LIBOR;

(2) a public statement or publication of information by the regulatory supervisor for the administrator of LIBOR, the U.S. Federal Reserve System, an insolvency official with jurisdiction over the administrator for LIBOR, a resolution authority with jurisdiction over the administrator for LIBOR or a court or an entity with similar insolvency or resolution authority over the administrator for LIBOR, which states that the administrator of LIBOR has ceased or will cease to provide LIBOR permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide LIBOR;

(3) [a LIBOR rate is not published by the administrator of LIBOR for five consecutive Business Days and such failure is not the result of a temporary moratorium, embargo or disruption declared by the administrator of LIBOR or by the regulatory supervisor for the administrator of LIBOR;]

(4) [a public statement or publication of information by the administrator of LIBOR that it has invoked or will invoke, permanently or indefinitely, its insufficient submissions policy; or]
(5) [a public statement by the regulatory supervisor for the administrator of LIBOR or any Governmental Authority having jurisdiction over the Lender announcing that LIBOR is no longer representative or may no longer be used.]

“Benchmark Replacement Date” means (a) for purposes of clauses (1) and (2) of the definition of “Benchmark Discontinuance Event,” the later of (i) the date of such public statement or publication of information and (ii) the date on which the administrator of LIBOR permanently or indefinitely ceases to provide LIBOR, (b) for purposes of clause (3) of the definition of “Benchmark Discontinuance Event,” the first Business Day following such five consecutive Business Days, (c) for purposes of clause (4) of the definition of “Benchmark Discontinuance Event,” the later of (i) the date of such public statement or publication of information and (ii) the date such insufficient submissions policy is invoked, and (d) for purposes of clause (5) of the definition of “Benchmark Discontinuance Event,” the later of (i) the date of such public statement and (ii) the date as of which LIBOR may no longer be used (or, if applicable, is no longer representative).
Specific Illustration:
Fannie Mae Form Adjustable Rate Note* /

ADJUSTABLE RATE NOTE

(LIBOR One-Year Index (As Published In The Wall Street Journal)—Rate Caps)

THIS NOTE CONTAINS PROVISIONS ALLOWING FOR CHANGES IN MY INTEREST RATE AND MY MONTHLY PAYMENT. THIS NOTE LIMITS THE AMOUNT MY INTEREST RATE CAN CHANGE AT ANY ONE TIME AND THE MINIMUM AND MAXIMUM RATES I MUST PAY.

4. INTEREST RATE AND MONTHLY PAYMENT CHANGES

(A) Change Dates

The interest rate I will pay may change on the first day of _____________, ______, and on that day every 12th month thereafter. Each date on which my interest rate could change is called a “Change Date.”

(B) The Index

Beginning with the first Change Date, my interest rate will be based on an Index. The “Index” is the average of interbank offered rates for one-year U.S. dollar-denominated deposits in the London market (“LIBOR”), as published in The Wall Street Journal. The most recent Index value available as of the date 45 days before each Change Date is called the “Current Index,” provided that if the Current Index is less than zero, then the Current Index will be deemed to be zero for purposes of calculating my interest rate.

If the Index is no longer available, the Note Holder will choose a new index which is based upon comparable information. The Note Holder will give me notice of this choice.

(C) Calculation of Changes

Before each Change Date, the Note Holder will calculate my new interest rate by adding percentage points (____ %) (the “Margin”) to the Current Index. The Note Holder will then round the result of this addition to the nearest one-eighth of one percentage point (0.125%). Subject to the limits stated in Section 4(D) below, this rounded amount will be my new interest rate until the next Change Date.

The Note Holder will then determine the amount of the monthly payment that would be sufficient to repay the unpaid principal that I am expected to owe at the Change Date in full on the Maturity Date at my new interest rate in substantially equal payments. The result of this calculation will be the new amount of my monthly payment.

* Used with the permission of Fannie Mae, whose contribution to this program is gratefully acknowledged.
Consumer Mortgage Substitution—Banking Authority

National Banks—12 C.F.R. §34.22—Index.

(a) In general. If a national bank makes an ARM loan to which 12 CFR 226.19(b) applies (i.e., the annual percentage rate of a loan may increase after consummation, the term exceeds one year, and the consumer's principal dwelling secures the indebtedness), the loan documents must specify an index or combination of indices to which changes in the interest rate will be linked. This index must be readily available to, and verifiable by, the borrower and beyond the control of the bank. A national bank may use as an index any measure of rates of interest that meets these requirements.
Consumer Mortgage Substitution—Banking Authority


(a) Authority. This regulation, known as Regulation D, is issued by the Bureau of Consumer Financial Protection to implement the Alternative Mortgage Transaction Parity Act, 12 U.S.C. 3801 et seq., as amended by title X, Section 1083 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, 124 Stat. 1376). Section 1004.4 is issued pursuant to the Alternative Mortgage Transaction Parity Act (as amended) and the Truth in Lending Act, 15 U.S.C. 1601 et seq.

12 C.F.R. §1004.4 Requirements for alternative mortgage transactions.

(a) Mortgages with adjustable rates or finance charges and home equity lines of credit. A creditor that makes an alternative mortgage transaction with an adjustable rate or finance charge may only increase the interest rate or finance charge as follows:

... 

(2) For all other transactions, the creditor must use either:

(i) An index to which changes in the interest rate are tied that is readily available to and verifiable by the borrower and beyond the control of the creditor;...
Consumer Mortgage Substitution—Banking Authority

• Components of substitution for consumer mortgage assets—
  – Authority to substitute held by the “Note Holder”
    • Securitizations and portfolio lenders may adopt different approaches with concurrent authority
    • Guaranty liability unclear
  – Adjustment based upon index value 45 days prior to adjustment
  – Adjustment to the margin may not be permissible
  – Banks may be limited to adopting index that is outside of bank control

• Notice Requirements
Speakers

Joseph T. Lynyak III – Dorsey & Whitney LLP

Joe Lynyak is a financial services partner in Dorsey & Whitney’s Financial Services Practice. Focusing his practice on the regulation and operation of financial service intermediaries, he provides counsel on strategic planning, application and licensing, legislative strategy, commercial and consumer lending, examination, supervision and enforcement and general corporate matters. He has extensive expertise across a comprehensive range of issues before federal and state regulatory agencies such as the Federal Reserve Board, OCC, FDIC, NCUA, CFPB, SEC, FTC and California and New York Banking Departments. Mr. Lynyak’s representative clients include foreign and domestic banks, savings associations, credit unions, holding companies and mortgage banking companies.

Email: Lynyak.joseph@Dorsey.com
Tel: 310.386.5554
Patience Omokhodion is a financial services partner in Cassels Brock’s Financial Services Practice in Toronto, Canada. She works on all types of secured and unsecured lending transactions, including US-Canada cross border transactions. She represents both lenders and borrowers. Having trained and begun her practice in the United Kingdom, Patience brings an international perspective to the practice of law. She has years of experience advising clients on the structuring and negotiation of debt finance and security arrangements involving a variety of industries and assets, including mining, aviation finance, equipment finance and leasing, and the travel industry. Patience was honored as a 2018 Lexpert “Rising Star”! and is a contributing author to Equipment Financing in Canada, published by LexisNexis, and Project Finance in Canada, published by Thomson Reuters.
Speakers

Thomas C. Baxter Jr. – Sullivan & Cromwell LLP

As a member of the Firm’s Financial Services Group, Thomas C. Baxter, Jr. focuses his practice on advising clients in the financial services, insurance, securities and FinTech spaces. Mr. Baxter’s advice relates to complex issues arising from supervision and regulation, investigations and enforcement actions, governance, compliance and risk management, crisis management and organizational culture. He also brings extensive experience dealing with central banks from around the world, and with sovereigns and their instrumentalities, as they address sovereign debt and dollar-liquidity issues. Mr. Baxter’s deep knowledge in these areas comes from more than 35 years at the Federal Reserve Bank of New York, most in senior leadership roles.

Email: baxert@sullcrom.com
Tel: (212) 558-4000
Questions?
References

• Alternative Reference Rates Committee
  – [https://www.newyorkfed.org/arrc](https://www.newyorkfed.org/arrc)
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