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In Practice

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Practical implications of USD LIBOR panel cessation for "tough legacy" contracts: a brief refresher

LIBOR cessation and contract continuity may seem like "old news". After all, most LIBOR rates ceased almost 18 months ago – and the last of the "synthetic" rates created for certain Sterling and Japanese Yen tenors will shortly expire. Nonetheless, the impending cessation of the final USD LIBOR panel rates on 30 June 2023 means that questions on legal implications are once again coming to the fore – especially given the FCA's announced intention to create a time-limited synthetic USD LIBOR rate. This piece provides a brief Q&A refresher.

LIBOR "tough legacy": This is generally interpreted to mean contracts without suitable fallbacks and which cannot be amended (or, in certain cases, cannot easily be amended – such as, requiring for majority bondholder approval for amendments).

LEGAL BASIS AND PRACTICALITIES

- **What are the UK FCA's intentions for USD LIBOR?** The UK FCA will require LIBOR's administrator (ICE) to publish certain US dollar LIBOR settings from 30 June 2023 to 30 September 2024, but using a "synthetic" methodology.
- **What empowers the UK FCA to act and what are the practical steps?** Using the powers awarded to it under the UK Benchmarks Regulation, on 3 April 2023 the UK FCA published:
  - a "notice of first decision" dated 14 March 2023 to compel ICE to publish synthetic USD LIBOR;
  - an "Art 23A" notice designating 1-, 3- and 6-month US dollar LIBOR as Art 23A benchmarks under the UK Benchmarks Regulation, with designation to take effect on 1 July 2023; and
  - two draft notices: an "Art 23C notice" to permit legacy use of synthetic US Dollar LIBOR by supervised entities, other than in the case of cleared derivatives; and an "Art 23D notice" to require IBA to calculate 1-, 3- and 6-month synthetic US dollar LIBOR settings. Final versions of notices will be published on 1 July 2023.
- **How will the synthetic rate be calculated?** The draft "Art 23D notice" indicates that the rate will be calculated using the relevant CME Term SOFR Reference Rate plus the respective ISDA fixed spread adjustment.

USE OF SYNTHETIC LIBOR

- **Which "tough legacy" contracts may use the synthetic rate?** This will largely be a question of contractual interpretation of LIBOR references. Parties will also need to consider any restrictions placed by any local regulator and, also, whether any relevant industry protocols apply. A key factor with regard to interpretation, however, will be any relevant "contract continuity" legislation:
  - For English law-governed contracts, the relevant legislation is the Critical Benchmarks (References and Administrators' Liability) Act 2021. This provides that, unless relevant fallbacks have been agreed, the relevant rate in the contract (or other arrangement) should be read as meaning the adjusted synthetic rate. The UK legislation was drafted to be neutral as to which designated benchmark was covered. Accordingly (once the FCA has made the relevant designations and has issued relevant notices), the Act will apply to USD LIBOR in that same way that it applied to Sterling and Japanese Yen LIBOR rates.
  - Legacy contracts that are governed by US law (eg New York law) and reference USD LIBOR may use synthetic USD LIBOR only if the Adjustable Interest Rate (LIBOR) Act does not supply a SOFR-based replacement benchmark by operation of law as of the "LIBOR replacement date" (currently expected to be 3 July 2023). For example, a legacy loan agreement that references USD LIBOR and includes customary alternate base rate provisions that reference a clearly defined alternate benchmark rate is generally understood to be out-of-scope for purposes of the US LIBOR Act. If such an agreement does not include a transition trigger that references the representative nature of USD LIBOR, the parties to such an agreement could refer to synthetic USD LIBOR, particularly when the definition of USD LIBOR in that agreement directs the parties to look to the screen on which synthetic USD LIBOR will be displayed.
  - Contracts within scope of the EU Benchmarks Regulation, as amended, will be unlikely to use synthetic USD LIBOR unless that is the rate so specified by the European Commission as a "Replacement Rate". It is as yet unclear whether the Commission will make any such determination; it did not do so for the Sterling or Yen synthetic rates.

USD RISK-FREE RATES (RFRs)

- **Overnight SOFR and TERM SOFR: Sample text:** In addition to the ARRC recommendations for SOFR, some industry bodies have prepared text. The LMA, for example, has published recommended form documentation containing frameworks for the use of SOFR compounded in arrears and Term SOFR.
- **Is Term SOFR still recommended only for a limited range of contracts?** ARRC continues to recommend overnight SOFR and SOFR averages for all products. Whilst its refreshed "best practice" guidance on scope of use of Term SOFR, published on 21 April 2023, included a limited expansion for derivatives, the paper acknowledges that use of the Term SOFR rates should remain limited. Whilst there is no prohibition on use of Term SOFR, some products (including bonds) still remain outside ARRC's recommendations. On RFR forward-looking term rates, more generally, practice in Europe with regard to "Term RFRs" has not yet changed. In the context of EURIBOR, for example, the Euro Working Group indicated that, for competition reasons, it has no plans to endorse any particular Term €STR rate out of the forward-looking rates which are starting to develop (such as, EMMI EFTERM or the prototype Refinitiv Term €STR). ■

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