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## **LEGAL UPDATES AND NEWS**

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### **Proposed Federal Reserve Regulations to Implement the LIBOR Act**

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The Board of Governors of the Federal Reserve System (the “Federal Reserve”) has proposed regulations to implement the Adjustable Interest Rate Act (the “LIBOR Act”). The LIBOR Act and the implementing regulations that the Federal Reserve is proposing are intended to address the discontinuation of the United States Dollar London Interbank Offered Rate (“LIBOR”) benchmark on June 30, 2023, by establishing a replacement benchmark, based on the Federal Reserve’s Secured Overnight Financing Rate (“SOFR”), that will automatically apply to agreements that rely on LIBOR and do not have a contractual non-LIBOR-based fallback benchmark.

#### **Contract Categories**

The Federal Reserve’s proposed regulations distinguish between three categories of contracts and the guidance applicable to each category: (1) contracts with fallback benchmarks that are not based on LIBOR and, therefore, do not require an inquiry into interbank lending or deposit rates (“Non-Covered Contracts”), (2) contracts with fallback provisions that authorize a particular person to determine the replacement benchmark (“Determination Contracts”) and (3) contracts that do not otherwise fall into the two categories, generally contracts with no fallback provisions (“Covered Contracts”).

Non-Covered Contracts will transition to their contractually agreed upon benchmark replacement on the first banking day after June 30, 2023 (the “LIBOR Replacement Date”).

For Determination Contracts, the applicability of a SOFR-based fallback will be determined by the determining person. Such determination must be made by the earlier of the LIBOR Replacement Date, or the determination date called for in the contract. If no determination is made by this date, the applicable SOFR-based fallback benchmark will apply automatically. If the determining person selects the SOFR-based fallback provided under the LIBOR Act, such decision is irrevocable. The Federal Reserve has indicated that it is aware of potential ambiguity if a contract’s fallback provisions that authorize a determining person to select a replacement benchmark are triggered only when LIBOR is unavailable without reference to whether LIBOR continues to be available but nonrepresentative. If synthetic LIBOR is published after the LIBOR Replacement Date, there may be disputes as to whether the determining person is authorized to select a replacement benchmark or whether synthetic LIBOR should be used. The Federal Reserve is considering whether its final implementing regulations should clarify whether the fallback provisions in these types of contracts should be triggered despite the availability of synthetic LIBOR.

Covered Contracts will automatically have their LIBOR benchmark replaced by the applicable SOFR-based fallback benchmark on the LIBOR Replacement Date.

**SOFR-Based Replacement Benchmarks**

Which SOFR-based fallback benchmark is utilized for Covered Contracts and applicable Determination Contracts will be determined based on the type of agreement. All of the proposed benchmark replacements are based on SOFR and incorporate spread adjustments for each specified tenor of LIBOR.<sup>1</sup> These adjustments are included in an attempt to address certain structural differences between SOFR and LIBOR.

Derivative Transactions: The LIBOR Act fallback benchmark will mirror the International Swaps and Derivatives Association’s LIBOR protocol – SOFR, compounded in arrears for the appropriate tenor, plus the stated spread adjustment for the appropriate tenor.

Cash Transactions Other than Consumer Loans and Contracts with a Government-Sponsored Enterprise (a “GSE”): Overnight LIBOR will be replaced by SOFR plus the stated overnight spread adjustment. The other LIBOR tenors will be replaced by a SOFR-based forward-looking term rate administered by CME Group, including the applicable spread adjustment.

Consumer Loans: Consumer loans will be treated the same as other cash transactions, except that for the first year after the LIBOR Replacement Date, the benchmark must incorporate an amount that transitions linearly for each business day during that period from (i) the difference between the replacement benchmark and the corresponding LIBOR tenor determined as of the day immediately before the LIBOR Replacement Date to (ii) the applicable tenor spread adjustment. Refinitiv Limited is permitted to publish fallback rates for consumer loans.

GSE Contracts: Where a GSE is a party to a contract that is a (i) commercial or multi-family mortgage loan, (ii) commercial or multi-family mortgage-backed security, (iii) collateralized mortgage obligation, (iv) credit risk transfer transaction, or (v) Federal Home Loan Bank advance, Overnight LIBOR will be replaced by SOFR plus the overnight spread adjustment (similar to other cash transactions). The other LIBOR tenors will be replaced by a 30-day compounded average of SOFR plus the applicable tenor spread adjustment.

**Safe Harbor Provisions/Opt-Outs**

Certain safe harbors are provided under the LIBOR Act and the Federal Reserve’s proposed implementing regulations. No person will be subject to any claim or cause of action, or have liability for damages, arising out of the selection or use of a benchmark replacement selected by the Federal Reserve. The LIBOR Act provides banks, financial market participants and other contractual parties with significant flexibility to opt-out and choose alternative replacement rates (e.g., Ameribor, BSBY). If all parties agree in writing that the LIBOR Act does not apply to their contract, the LIBOR Act will not alter or impair such agreement. There will be no negative inference or presumption regarding the validity or enforceability of any benchmark replacement (including any method for calculating, determining, or implementing an adjustment to the benchmark replacement to account for any historical differences between LIBOR and the benchmark replacement) that is not a Federal Reserve-selected benchmark replacement, or any changes, alterations, or modifications to or with respect to a LIBOR contract that are not benchmark replacement conforming changes. Any such changes will, however, not benefit from the safe harbor provisions.

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<sup>1</sup> 0.644 basis points (“bps”) for overnight, 11.448 bps for one month, 26.161 bps for three months, 42.826 bps for six months and 71.513 bps for 12 months.

**Next Steps**

While the September 11, 2022 date set forth in the LIBOR Act for the Federal Reserve to adopt implementing regulations recently passed without final action by the Federal Reserve, the public comment period on the regulations did end on August 29<sup>th</sup> and the Federal Reserve has stated that the regulations will be adopted well in advance of June 30, 2023.

While the LIBOR Act will help to transition legacy LIBOR contracts to a new benchmark, the Federal Reserve has noted that the substitution of SOFR for LIBOR may have potentially significant economic impacts on parties to Covered Contracts. Furthermore, the Federal Reserve's use of slightly different SOFR-based fallback benchmarks for different types of contracts could give rise to issues like hedging mismatches.

Financial institutions with contracts that utilize LIBOR should consider:

1. reviewing affected contracts and determining the impact of any statutory or contractual fallback benchmarks;
2. creating an inventory of identified fallback triggers in these contracts;
3. determining if any subset of the company's contracts should be renegotiated to select alternative rates and terms; and
4. outlining the company's approach and prioritization for any renegotiations.

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Please contact any of our attorneys below if you have any questions regarding the information contained in this newsletter.

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