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In this report, Young and Humphreys analyze the tax issues raised by outstanding debt instruments that adopt any of the various recommended replacements for LIBOR.

The information in this report is of a general nature and is based on authorities that are subject to change. The report represents the views of the authors only and does not necessarily represent the views or professional advice of Mayer Brown LLP.

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As you may have heard, the debt market must break up with its longtime partner, LIBOR. In the United States, the Alternative Reference Rates Committee (ARRC) is serving as matchmaker to help the market move on and find a replacement for U.S. dollar LIBOR. This report provides background on the replacement rates proposed by the ARRC, details the ARRC's recommended language for various debt instruments, and examines some federal income tax considerations concerning the replacement of LIBOR.

On August 28, 2019, Treasury submitted proposed regulations under section 1001 providing guidance on the U.S. federal tax consequences of the phased elimination of LIBOR, for review by the Office of Management and Budget's Office of Information and Regulatory Affairs.[1] Thus, proposed regulations and/or other guidance (hopefully) addressing the considerations discussed in this report are expected soon.[2]

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[1] *See* Guidance on the Elimination of Interbank Offered Rates, which is available on the Office of Information and Regulatory Affairs' website.

[2] The Office of Management and Budget generally reviews regulations it receives within 45 days. *See* Memorandum of Agreement between the Department of the Treasury of Management and Budget Review of Tax Regulations under Executive Order 12866.

I. Background

LIBOR dates back to the late 1960s and 1970s, when it was used in syndicated loan transactions.[3] The British Bankers Association (BBA) assumed responsibility for LIBOR in 1986 as the European market in debt instruments and associated swaps expanded. The BBA organized a panel of large banks in London to answer a basic question: "At what rate could you borrow funds, were you to do so by asking for and then accepting interbank offers in a reasonable market just prior to 11 a.m.?"[4] After a series of scandals (including the LIBOR rigging scandals) in the period after the late 2000s financial crisis, responsibility for LIBOR was transferred from the BBA to the United Kingdom's Financial Conduct Authority. Today it is administered by the Intercontinental Exchange (ICE) Benchmark Authority (IBA), and its official name is ICE LIBOR.

LIBOR is produced for five currencies (Swiss francs, the euro, the pound sterling, the Japanese yen, and U.S. dollars) and in seven tenors (overnight/spot next, one week, one month, two months, three months, six months, and one year) based on submissions from reference panels of between 11 and 16 banks for each currency. It is used in various debt instruments, notional principal contracts, and other derivatives. U.S. dollar LIBOR is by far the most used LIBOR rate, with the ARRC estimating that it is used in more than $200 trillion of market transactions.[5]

Since the financial crisis and the LIBOR rigging scandals, LIBOR has been under fire largely because of its subjective nature (that is, it is not based on actual transactions). In July 2017 Andrew Bailey, the Financial Conduct Authority's chief executive, gave a speech titled "The Future of LIBOR." After summarizing LIBOR's strengths and weaknesses, Bailey observed that work on transition from LIBOR was unlikely to begin in earnest if market participants assumed it would last indefinitely. He then outlined an understanding with the LIBOR panel banks to voluntarily agree to sustain LIBOR until year-end 2021. He said, "Our intention is that at the end of the period, it would no longer be necessary for the [Financial Conduct Authority] to persuade, or compel, banks to submit to LIBOR." There is, however, no set date when LIBOR will end. In fact, the IBA's goal in obtaining sufficient banking support to publish some widely used LIBOR settings after year-end 2021 is "to provide these settings to users with outstanding LIBOR-linked contracts that are impossible or impractical to modify."[6]

LIBOR was intended to measure interest rates in real market transactions. However, the market that LIBOR measures — unsecured term lending between banks — has declined in size over the years. For example, in his speech, Bailey noted that for one currency-tenor combination in which a benchmark rate was produced every day using submissions from around a dozen panel banks, the banks, between themselves, "executed just 15 transactions of potentially qualifying size in that currency and tenor in the whole of 2016." Accordingly, LIBOR has become in some (or many) cases more a matter of expert judgment than a measurement based on actual transactions.

The original LIBOR submission question has been replaced with a waterfall method, which still focuses on what interest rates major banks would borrow at for short-term instruments.[7] The transition to the waterfall method was completed April 1, at which point all panel banks were using it to make LIBOR submissions.[8]

[3]For a description of the history of LIBOR, see the Intercontinental Exchange, "ICE LIBOR Evolution," at 4 (Apr. 25, 2018).

[4]This is the LIBOR submission question. Originally, the question was: "At what rate do you think interbank term deposits will be offered by one prime bank to another prime bank for a reasonable market size today at 11 a.m.?" The question was changed to its current form in 1998.

[5]ARRC, "Transition From LIBOR."

[6]ICE, "ICE Benchmark Administration Survey on the Use of LIBOR." In fact, the IBA has proposed its own index of interest rates: the U.S. Dollar ICE Bank Yield Index.

[7]The waterfall method has three levels: Level 1 is transaction based, looking at a volume-weighted average price of actual transactions, with a higher weighting for transactions booked closer to 11:00 a.m., London time. Level 2 is transaction derived, looking at time-weighted historical eligible transactions adjusted for market movements and linear interpolation. Level 3 is based on expert judgment using the panel bank's own internally approved procedure based on a set of permitted inputs and agreed with the IBA.

[8]*See* ICE, "ICE Benchmark Administration Successfully Completes the Transition of LIBOR Panel Banks to the Waterfall Methodology" (Apr. 1, 2019).

In 2014 the U.S. Financial Stability Oversight Council (FSOC)[9] and the Financial Stability Board[10] called for the development of alternatives to LIBOR.[11] In response, the ARRC was convened by the board of governors of the Federal Reserve System and the Federal Reserve Bank of New York. ARRC's membership consists of 31 major financial institutions and companies, with 10 U.S. government agencies (including Treasury) serving as ex officio members. The ARRC has 10 working groups, including a legal working group, an accounting-tax working group, and a working group for specific structures such as floating rate notes (FRNs) and securitizations.

In 2017 the ARRC recommended the Secured Overnight Financing Rate (SOFR) as the replacement for LIBOR.[12] As discussed later, SOFR represents the interest rate on overnight U.S. treasury repurchase agreements. Unlike LIBOR, for which the panels set overnight, one-week, one-month, two-month, three-month, six-month, and one-year terms, there are no such term rates for SOFR. In February analysts with the Federal Reserve in Washington suggested a method to use the values of SOFR futures contracts (which are traded on the Chicago Mercantile Exchange) as a basis for determining term SOFR rates.[13] However, the ARRC has not recommended this method. Thus, although the Federal Reserve Bank of New York publishes SOFR daily, it does not publish any term SOFR values.[14]

In the first half of 2019 the ARRC published recommendations for LIBOR replacement language in four different types of newly issued LIBOR debt instruments: FRNs, securitizations, syndicated loans, and bilateral business loans. The recommendations have sample contract language, including recommended triggers and definitions of the fallback rates, as well as explanations of the contractual provisions. As described below, the provisions, while addressing the same problem, are actually somewhat different when compared side by side.

On July 15 John C. Williams, president and CEO of the Federal Reserve Bank of New York, gave a speech titled "901 Days," referring to the time before December 31, 2021. In it, he reviewed LIBOR's perceived deficiencies and the steps already taken to replace it. He also discussed SOFR and the fact that various criticisms have been leveled at SOFR for lack of a term rate. Then he said the biggest challenge was market complacence: "In my view, the biggest challenge isn't liquidity or the creation of a term rate, it's a willingness on the part of the market to stop using LIBOR." If companies are using LIBOR, "they need to start including robust fallback language in the contract, so that if LIBOR ceases to exist chaos does not ensue," Williams said. "My message: Don't wait for term rates to get your house in order."

Finally, the SEC staff recently published a statement and encouraged market participants to proactively manage their transition away from LIBOR.[15]

II. ARRC-Recommended Fallbacks

To understand the scope of the LIBOR replacement problem, one can consider what will happen for four groupings of instruments when LIBOR ceases to be published:

1. *Outstanding debt instruments that have no LIBOR fallback*: We did not always live in a

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[9]The FSOC is a U.S. governmental organization created by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 112 of Dodd-Frank requires the council to (1) identify risks to U.S. financial stability that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or non-bank financial companies, or that could arise outside the financial services marketplace; (2) promote market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of those companies that the government will shield them from losses in the event of failure; and (3) respond to emerging threats to the stability of the financial system. *See* Congressional Research Service, "Financial Stability Oversight Council (FSOC): Structure and Activities," R45052 (Feb. 12, 2018).

[10]The Financial Stability Board is an international organization formed after the financial crisis. It was endorsed by the G-20 in 2009. The board monitors and makes recommendations about the global financial system to promote international financial stability.

[11]Principle 13 of the International Organization of Securities Commissions' Principles for Financial Benchmarks provides that users should be encouraged by administrators to "take steps to make sure that contracts or other financial instruments that reference a benchmark have robust fallback provisions in the event of [cessation of] the referenced benchmark." *See* International Organization of Securities Commissions, "Principles for Financial Benchmarks: Final Report," at 24 (July 2013).

[12]*See* ARRC, "A User's Guide to SOFR" (Apr. 2019).

[13]Erik Heitfield and Yang-Ho Park, "Inferring Term Rates From SOFR Futures Prices," Finance and Economics Discussion Series 2019-014, Federal Reserve Board (Feb. 5, 2019).

[14]The Federal Reserve Bank of New York intends to publish averages of daily SOFRs beginning in 2020.

[15]SEC, "Highlighting Risks for Market Participants to Consider as They Transition Away From LIBOR" (July 12, 2019).

time when anyone anticipated that LIBOR could cease to exist. Many legacy debt instruments do not have a LIBOR fallback. Also, it is possible that some debt instruments are still being issued without fallbacks. In these cases, depending on the transaction, issuers may have to resort to several strategies to address the problem, including soliciting consents to change the rate, calling instruments when a call is available, and offering exchanges.

2. *Outstanding debt instruments that include a LIBOR fallback*: Some issuers have been including LIBOR fallbacks in newly issued debt instruments for some time. Of course, these fallbacks initially were not standardized. Each provision will have to be analyzed separately to determine what the new rate will be and the tax consequences of shifting from LIBOR to the fallback rate.
3. *Outstanding debt instruments with ARRC-recommended fallbacks*: The ARRC's hope is for market participants to adopt standardized fallback language in preparation for LIBOR's demise. The ARRC's approach, as described more fully later, has been to lay out various waterfalls with specified rates for different market segments to allow issuers to draft fallback provisions that will have some uniformity. These fallback provisions vary based on the type of debt instrument because of specific demands of the market for that type of instrument. Also, the ARRC recommendations are designed to operate when any benchmark rate — not only LIBOR — ceases to exist, including an ARRC-recommended replacement (with an eye toward avoiding a repeat of the LIBOR problem).
4. *New debt instruments issued after LIBOR is gone*: Once LIBOR is gone, new instruments will have a new default rate. However, given the possibility that the market will not immediately agree on a prevailing LIBOR substitute, the default rate may have backups if the default rate ceases to be published.

This report focuses on the third class of debt instruments: those that adopt the ARRC fallback provisions. There are, of course, additional tax issues when considering the other groupings, but many of the principles discussed here will be relevant to those instruments. Also, as noted earlier, LIBOR is used in many non-debt instruments. Again, the principles discussed here are relevant (but not necessarily dispositive) when considering the effect of the LIBOR breakup on those instruments.[16]

To analyze the tax considerations of the ARRC recommendations for replacing U.S. dollar LIBOR, one needs to have a clear understanding of the precise contents of the recommendations. We first examine the ARRC's proposed trigger and proposed replacement rates and then examine the ARRC's proposed waterfall for four types of deal documentation.

A. Fallback Trigger

An integral part of replacing LIBOR is identifying the triggers that determine when LIBOR (which is a benchmark) should be replaced in a debt instrument. The ARRC triggers to date are generally the same for each category of debt instrument in the ARRC recommendations.[17] They include:

- a public statement of information by or on behalf of the administrator of the benchmark rate announcing that the administrator has ceased or will cease to provide the benchmark permanently or indefinitely;
- a public statement or publication of information by (1) the regulatory supervisor for the administrator of the benchmark, (2) the central bank for the currency of the benchmark, (3) an insolvency official with jurisdiction over the administrator of the benchmark, (4) a resolution authority with

[16] The International Swaps and Derivatives Association is working on LIBOR fallbacks for various derivatives; *see also* ISDA, "Consultation on Pre-Cessation Issues for LIBOR and Certain Other Interbank Offered Rates (IBORs)" (2019).

[17] The ARRC business loan recommendation refers only to replacing LIBOR; the other ARRC recommendations refer more generally to replacing any benchmark. Thus, these provisions could operate more than once if LIBOR is replaced with Benchmark A and Benchmark A itself later undergoes a benchmark transition event, etc.

jurisdiction over the administrator of the benchmark, or (5) an entity with similar insolvency or resolution authority over the administrator for the benchmark, in each case stating that the administrator of the benchmark has ceased or will cease to provide the benchmark permanently or indefinitely; and

- a public statement or publication of information by the regulatory supervisor for the administrator of the benchmark announcing that the benchmark is no longer representative.[18]

The ARRC recommendations customize this approach for some structures. For example, the ARRC securitization recommendation (as defined later) includes as a potential benchmark transition event that the "asset replacement percentage" is greater than 50 percent (that is, a point at which more than half the assets in the securitization have had their own LIBOR rates replaced with a different benchmark).

When considering the tax implications of the ARRC recommendations, keep in mind that LIBOR has long been the accepted standard in the market for floating rate debt, and the market will likely settle on a new market standard. However, at this point there is no guarantee that the new market standard will necessarily be a rate recommended by the ARRC. Moreover, the ARRC proposals are not legally required and are binding only on parties that choose to adopt them in their documentation. As the ARRC FRN recommendations observe, "the extent to which any market participant decides to implement or adopt any suggested contract language is completely voluntary."[19]

B. Fallback Rates

1. SOFR.

As noted, the ARRC has recommended SOFR as the primary fallback rate. So what is SOFR? SOFR measures the cost of overnight borrowings through repo transactions collateralized with U.S. treasury securities. Unlike LIBOR, it is always based on actual transactions.

As will be seen, some of the tax considerations surrounding SOFR as a component of a replacement for LIBOR center on the inherent difference between LIBOR and SOFR. LIBOR looks to estimates of lending transactions today, as a forward-looking rate (that is, the rate a bank would charge), while SOFR is based on interest rates for actual transactions. One could say SOFR is more accurate because it produces a rate based on actual trades. On the other hand, one could also say SOFR is less accurate because it cannot adapt to current market conditions. Also, SOFR has been criticized as being volatile from day to day, in particular around quarter- and year-end.[20]

2. Term SOFR plus adjustment.

Term SOFR plus adjustment would be a forward-looking rate with a tenor matching the LIBOR tenor selected or recommended by the relevant governmental authority (that is, the ARRC). One might find it difficult to see how a backward-looking rate such as SOFR could be included as a component of a forward-looking rate such as term SOFR, and one would not be alone. As noted, the ARRC is still studying the creation of term SOFRs, and there is no guarantee that this rate will exist before LIBOR goes away. However, the ARRC plans to create a term SOFR before the end of 2021.[21]

3. Compounded SOFR plus adjustment.

At the end of an interest period, compounded SOFR would create a compounded average of the daily SOFRs during that period. The ARRC recommendations also allow the use of a simple average rather than a compounded SOFR.[22] As discussed later, a compounded SOFR could be the fallback rate after 2021 under the ARRC recommendations because of the possible unavailability of term SOFR.

[18] *See, e.g.*, ARRC, "ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Floating Rate Notes" (Apr. 25, 2019).

[19] *See id.* at 3.

[20] One other period of volatility is observed on days surrounding the Federal Reserve Board Open Market Committee's interest rate decisions. *See* Heitfield and Park, *supra* note 13, at 3.

[21] *See* ARRC, "Transition From LIBOR," *supra* note 5.

[22] The difference between simple average and compounded SOFR are explained in the ARRC SOFR guide, *supra* note 12.

4. Relevant government-body-selected rate.

This rate is designed to address a situation in which SOFR itself is discontinued and the ARRC or a SOFR replacement rate committee comes up with a new rate. Of course, there is some irony in a fallback waterfall having a leg based on the potential demise of its own proposed fallback rates.

5. ISDA fallback rate.

At this step, the issuer of a debt instrument would look to the fallback rate used by the International Swaps and Derivatives Association in Supplement No. 57 to the 2006 ISDA definitions. The ISDA has its own sequence, looking first to the ARRC's recommended SOFR, next to the overnight bank funding rate published by the Federal Reserve Bank of New York, then finally to the Federal Open Market Committee target rate published by the Board of Governors of the Federal Reserve.

6. Adjustment.

As will be seen, each rate in the fallback waterfalls includes an adjustment. The ARRC-recommended adjustment varies by deal structure, and the amount of the adjustment itself has a waterfall in each case. For example, for FRNs[23]:

Step 1: ARRC-selected adjustment
Step 2: ISDA fallback adjustment
Step 3: Issuer- or designee-selected adjustment

Note that the ARRC adjustment here is intended to work only with term SOFR, and the ISDA adjustment is similarly intended to work only with an ISDA fallback rate. If term SOFR does not exist, an FRN using the ARRC waterfall would fall back to compounded SOFR. This would mean that the amount of the adjustment for compounded SOFR would be up to the issuer or its designee, after considering any industry-accepted spread adjustment or method for calculating or determining that adjustment.

C. Proposal for Floating Rate Notes

The ARRC FRN recommendation adopts a hard-wired approach. Thus, if the trigger is met (that is, a benchmark transition event has occurred), the benchmark is automatically replaced by a "benchmark replacement."

The ARRC recommends that before going down its waterfall, an issuer of LIBOR FRNs first use an interpolated LIBOR based on other tenors of LIBOR, if those tenors are still available. For this interpolation to work, there must be a LIBOR value for a tenor shorter than the desired tenor, and a LIBOR value for one longer than the desired tenor. For example, if three-month LIBOR ceases but one-month and six-month LIBORs still exist, the ARRC recommends that issuers of FRNs use an interpolated LIBOR.

Assuming interpolated LIBOR is unavailable, the ARRC's recommended waterfall for FRNs is as follows[24]:

Step 1: Term SOFR plus adjustment
Step 2: Compounded SOFR plus adjustment
Step 3: Relevant government-body-selected rate plus adjustment
Step 4: ISDA fallback rate plus adjustment
Step 5: Issuer- or designee-selected rate plus adjustment

The adjustment waterfall for FRNs is the waterfall set forth above.

Any decisions necessary under the ARRC's recommended provisions are made by the issuer or its designee. The provisions include language indicating that absent manifest error, any determinations, actions, or failures to take actions by the issuer or its designee are conclusive and binding. The parties may also discuss and seek to assign responsibility for making those decisions and determinations in a manner consistent with other provisions of their transaction (that is, assignment to a third-party trustee).[25]

[23] *See, e.g.*, ARRC FRN recommendations, *supra* note 18.

[24] *See id.*

[25] *Id.*

D. Proposal for Securitizations

As with the FRN proposal, the preliminary step for replacing LIBOR is to use an interpolated LIBOR based on other tenors of LIBOR, if those tenors are still available. If they are unavailable, the ARRC's recommended waterfall for securitizations is as follows[26]:

Step 1: Term SOFR plus adjustment
Step 2: Compounded SOFR plus adjustment
Step 3: Relevant government-body-selected rate plus adjustment
Step 4: ISDA fallback rate plus adjustment
Step 5: Transaction-specific fallback rate plus adjustment

The unique feature here is the leeway for a transaction-specific fallback rate. The substance, however, is the same as step 5 for FRNs, in that step 5 is a catchall left to the discretion of the parties.

The adjustment waterfall for LIBOR securitizations is as follows:

Step 1: ARRC-recommended adjustment
Step 2: ISDA fallback adjustment
Step 3: Designated-transaction-representative-selected adjustment

The ARRC securitization recommendations provide that decisions under the provisions are made by a "designated transaction representative." This is defined as, "with respect to a particular securitization transaction and a particular obligation to be performed in connection with the transition to a Benchmark Replacement, the party identified by the transaction documents to perform that obligation." Thus, the designated transaction representative could be the borrower, the lender, or a third party.

E. Proposal for LIBOR Syndicated Loans

The ARRC's approach to syndicated loans is unique, in that the ARRC-recommended waterfall for syndicated loans has a hard-wired alternative and a discretionary alternative. They are as follows[27]:

1. Hard-wired approach benchmark replacement.

Step 1(a): Term SOFR plus adjustment
Step 1(b): Next available term SOFR plus adjustment
Step 2: Compounded SOFR plus adjustment[a]
Step 3: Borrower- and administrative-agent-selected rate plus adjustment
[a]Although the ARRC recommends using compounded SOFR, it does provide a suggested alternative: using a simple average SOFR plus an adjustment.

The adjustments for each benchmark replacement are as follows:

Steps 1 and 2: ARRC-selected adjustment, then ISDA fallback adjustment
Step 3: Borrower- and administrative-agent-selected adjustment

2. Amendment approach.

The amendment approach provides that upon a trigger event or an "early opt-in," the administrative agent and the borrower may amend the agreement to replace LIBOR with a benchmark replacement. If a trigger event has occurred, the amendment becomes effective five days after notice unless enough lenders (as determined in the agreement) object. For an early opt-in, the amendment becomes effective when sufficient lenders (as determined under the agreement) accept it.

In this case, the benchmark replacement is one selected by the administrative agent and the borrower (giving due consideration to selection or recommendation by a relevant governmental body, which includes the ARRC) and a benchmark replacement adjustment.

[26]*See* ARRC, "ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Securitizations" (May 31, 2019).

[27]*See* ARRC, "ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Syndicated Loans" (Apr. 25, 2019).

The ARRC LIBOR syndicated loan recommendation provides that required determinations are made by the administrative agent (for the hard-wired recommendation) and by both the administrative agent and the borrower (for the amendment recommendation). Unlike the ARRC FRN recommendation, the ARRC LIBOR syndicated loan recommendation includes an early opt-in election that triggers the LIBOR replacement. This occurs if (1) the administrative agent or the borrower asks the administrative agent to notify each party that several outstanding U.S.-dollar-denominated syndicated credit facilities at that time contain term SOFR plus a benchmark replacement adjustment in lieu of LIBOR; and (2) the administrative agent, the borrower, and the required lenders by affirmative vote declare that an early opt-in election has occurred, and the administrative agent notifies all the parties.

F. Proposal for LIBOR Bilateral Business Loans

The ARRC recommendations for LIBOR bilateral business loans were issued May 31.[28] The recommendations include a hard-wired approach, an amendment approach, and a hedged loan approach.

In the hard-wired approach, the replacement waterfall is as follows:

Step 1: Term SOFR plus adjustment or next available term SOFR plus adjustment
Step 2: Compounded SOFR plus adjustment
Step 3: Lender-selected rate plus adjustment

The adjustment waterfall for LIBOR bilateral business loans is as follows:

Steps 1 and 2: ARRC-recommended adjustment, then ISDA fallback adjustment
Step 3: Lender-selected adjustment

The amendment approach is similar to that found in the ARRC syndicated loans recommendation.

The hedged loan approach uses as a benchmark replacement "the sum of the successor rate and spread adjustment that would apply for derivatives transactions referencing the ISDA Definitions upon the occurrence of an index cessation date with respect to the Benchmark for the applicable tenor."[29] Therefore, it is designed to use the same benchmark replacement that the issuer's swaps are using and the corresponding ISDA adjustment.

In the ARRC business loans recommendation, it is the lender, not the borrower, that has discretion over the rate replacement. The lender also has the ability to elect an early opt-in, along the lines of the opt-in in the ARRC syndicated loans recommendation.

III. Tax Considerations

A. Considerations for Replacement

1. Significant modifications generally.

The main federal income tax consideration for the replacement of a LIBOR rate on an outstanding debt instrument is whether the replacement results in a significant modification under reg. section 1.1001-3. If the replacement of LIBOR is not a significant modification, all is well; if the replacement is a significant modification, holders of the debt instrument would have a deemed exchange of their "old" note for a "new" note.

The regulations define a modification to mean any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or a holder of a debt instrument.[30] The regulations go on to say that an alteration of a legal right or obligation that occurs by operation of the terms of the debt instrument is not a modification.[31] Such an alteration may occur automatically or as the result of an option provided to the issuer or holder to change the terms of a debt instrument.[32] Some alterations, however, are modifications even if they occur by operation of the debt instrument's terms. In

[28] *See* ARRC, "ARRC Recommendations Regarding More Robust Fallback Language for New Originations of LIBOR Bilateral Business Loans" (May 31, 2019).

[29] *Id.* at 13.

[30] Reg. section 1.1001-3(c)(1)(i).

[31] Reg. section 1.1001-3(c)(1)(ii).

[32] *Id.*

particular, an alteration that results from the exercise of an issuer or holder's option to change a term of a debt instrument is a modification unless (1) the option is unilateral or, (2) for a holder option only, the exercise does not result in a deferral of or reduction in any scheduled payment of principal or interest.

An option is unilateral only if, under the debt's terms or applicable law, (1) there does not exist, at the time of exercise or as a result of exercise, a right of the other party to alter or terminate the debt instrument or to put the instrument to a person related (using a more-than-50-percent standard) to the issuer; (2) the exercise of the option does not require the consent of the other party, a related party, or a court; and (3) the exercise of the option does not require consideration unless on the debt instrument's issue date the consideration is a de minimis amount, a specified amount, or based on a formula that uses objective financial information.[33]

A modification will be a significant modification only if it is treated as significant under specified tests in the regulations. There are two potentially applicable tests for purposes of the LIBOR replacement analysis. The first is the change-in-yield test, which applies only to fixed payment debt instruments, debt instruments with alternative payment schedules under the original issue discount regulations, debt instruments with a fixed yield under the OID regulations, and variable rate debt instruments (VRDIs).

Under the change-in-yield test, a change in the yield of a debt instrument generally results in a significant modification only if the difference in yield of the instrument before the modification is more than the greater of (1) 0.25 percent or (2) 5 percent of the annual yield of the instrument.[34] For purposes of the change-in-yield test, the annual yield of a VRDI (which is the classification of most FRNs) is the annual yield of the equivalent fixed-rate debt instrument constructed under the VRDI rules as of the date of the modification.[35]

If a debt instrument is ineligible for the change-in-yield test (that is, contingent payment debt instruments), a change in yield could be tested under a general facts and circumstances test.[36]

2. Application to the replacement of LIBOR.

The application of the significant modification rules to the replacement of a LIBOR interest rate on a debt instrument under the ARRC framework is best examined through an example.

Example: Assume that a medium-term note program for the offering of FRNs fully implements the ARRC FRN recommendations discussed earlier (the five-step waterfall). Assume further that LIBOR replacement determinations are made by the issuer or its designee (that is, a calculation agent) for the program.

The tax adviser in September 2019 must consider whether the ARRC FRN recommendation could result in a significant modification of the medium-term notes under reg. section 1001-3 if the replacement provisions are triggered at some future date.

The ARRC FRN recommendation basically uses a hard-wired approach. Thus, once a benchmark transition event occurs, the calculation agent must go down the five-step waterfall. The draft language provides that the benchmark replacement is the "first alternative set forth in the order below that can be determined by the issuer or its designee." Thus, the calculation agent cannot skip to step 5 and simply pick an alternative rate of interest. The same is true for the benchmark replacement adjustment that accompanies the new rate: The calculation agent must pick the first alternative available in order.

There is some discretion, however, under the ARRC FRN recommendations. First, when the calculation agent gets to step 3 in the benchmark replacement adjustment waterfall, it is directed to use "the spread adjustment . . . that has been selected by the issuer or its designee giving due consideration to any industry accepted spread adjustment or method for calculating . . . such spread adjustment." So the calculation agent has

[33] Reg. section 1.1001-3(c)(3).

[34] Reg. section 1.1001-3(e)(2).

[35] Reg. sections 1.1001-3(e)(2)(iv) and 1.1275-5(e).

[36] Reg. section 1.1001-3(e)(1).

to be mindful of industry-accepted spread adjustments (if they exist), but otherwise is left with discretion. Second, once the calculation agent gets to step 5 in the replacement waterfall, it must use "the alternative rate of interest that has been selected by the issuer or its designee as the replacement for the then-current Benchmark . . . giving due consideration for any industry accepted rate of interest as a replacement." Again, as with the benchmark replacement adjustment, there is significant discretion, or in September 2019 it seems there may be, because there are no industry-accepted rates other than perhaps LIBOR.

The question under reg. section 1.1001-3 is whether the automatic shift to the replacement rates, or the discretion that remains even in the ARRC FRN recommendation, means that an exchange has occurred when there is a benchmark transition event.

In the first instance, automatic changes to specified fallback rates or adjustments, as in steps 1 through 4 of the replacement waterfall and steps 1 and 2 in the adjustment waterfall, should not result in modification of the debt instrument. Instead, they should be seen as changes to the debt instrument in accordance with a unilateral issuer's exercise of an option to modify the debt instrument. The discretionary modifications under step 5 in the replacement waterfall and step 3 in the adjustment waterfall are not automatic, and therefore raise a harder question. However, the unilateral option rules are written quite broadly for issuer options. They do not say that the issuer's option has to be between choices A and B (that is, between predefined choices). Instead, there seems to be no limit on an issuer's option to change the interest rate on the debt instrument. Contrast this with holder options. If a holder option results in a deferral or reduction of payments, the exercise of that option is a modification. There are no similar restrictions on an issuer's unilateral option.

The analysis will change, however, if the holders have a right to consent to the replacement rate. The ARRC FRN recommendations do not include any consent rights. Assuming the corporate lawyers have not decided to drop one in, replacement of the LIBOR rate seems to pass muster and should not be a modification under reg. section 1.1001-3. Contrast this with the ARRC syndicated loan replacement provisions. There, a benchmark termination event includes an early opt-in under which the borrower or its agent notifies the lenders that term SOFR is being used in a defined number of other syndicated loans, and the required lenders vote to declare that an early opt-in has occurred. This would seem to be an option when consent is required. The same is true in the ARRC bilateral business loan recommendation, under which it is the lenders that have discretion over the rate replacement, as well as an early opt-in, but the borrower may be given the right to object to the early opt-in.[37]

The fact that under the ARRC FRN recommendation there is an adjustment to reflect the difference between LIBOR and the replacement rate should not change the unilateral option analysis. This should be true when the adjustment is an adjustment to the spread (that is, compounded SOFR plus 50 basis points, with 30 basis points representing the credit spread and 20 basis points representing the adjustment). It should also be true when the adjustment is a one-time payment.

Tax advisers should keep in mind that the ARRC does not specifically warrant that the use of its recommendations will not result in a section 1001 event if the replacement provisions are triggered. In a white paper prepared for Treasury and the IRS, the ARRC states that "the operation of fallback language upon the occurrence of its triggering event should not result in a taxable exchange of a debt instrument, assuming the fallback provision applies automatically."[38] The paper goes on to urge Treasury to issue "broad and flexible" guidance ensuring that "transition from LIBOR not be a taxable event with respect to a debt obligation." The ARRC's suggested guidance published in June would provide that the change from an interbank offered rate (IBOR) to a "qualified replacement rate" would not result in an exchange of the debt instrument. A qualified replacement rate includes any qualified floating rate (QFR) under the VRDI regulations (without

[37] This is bracketed language in the ARRC bilateral business loan recommendations, *supra* note 28.

[38] ARRC, "U.S. Federal Income Tax Issues Relating to the Transition From IBORs to RFRs" (Apr. 8, 2019) (white paper).

regard to the multiples limit in the regulations), any rate recommended by the ARRC or a comparable non-U.S. organization or non-U.S. regulator, or a rate the commissioner identifies.

Another issue to consider is who is making the replacement decisions. In our example, the replacement determination will be made by the calculation agent for the deal (as is common). Reg. section 1.1001-3 applies only to modifications by the issuer or the holder. Therefore, to be able to rely on the regulations, the adviser should be comfortable that the party making the determinations is treated as the issuer or holder's agent.[39] The ARRC FRN recommendation provides that the issuer or its designee makes the replacement decisions; however, this could obviously be modified in any particular contract. Also, the other ARRC recommendations take different approaches. For example, in the ARRC securitization recommendations, decisions are made by a designated transactions representative, which can be anyone identified in the documents.

In the collateralized loan obligation (CLO) space, the portfolio manager typically exercises significant discretion in determining how, and in some cases when, LIBOR is replaced. This is sensible for CLOs, because a CLO pools together a package of primarily floating-rate leveraged loans from various issuers. A CLO might not want to provide for a specific fallback rate in its indenture, because, as mentioned, it is still feasible that the market standard in the leveraged loan market will become a rate other than SOFR. If a CLO switched to one rate and a significant portion of its portfolio were using another, this could create basis risk. Providing flexibility to the portfolio manager to replace LIBOR protects against this risk.

Depending on the circumstances, the portfolio manager may or may not be treated as the issuer of the CLOs for federal income tax purposes. If not, an "out" for a unilateral issuer's option may not be available. Moreover, typically one or more classes of CLO investors hold a majority consent right regarding the replacement rate if that rate is not determined by reference to specified objective criteria (for example, the rate used by more than 50 percent of the loans in the CLO portfolio), which means that the option is not unilateral after all in those cases. Because the replacement is not under the terms of the CLO instrument either because of the portfolio manager's discretion or the consent right, there is a real risk that the replacement could cause a significant modification. Standard CLO documentation addresses this risk, often in both the discussion of the risk factors and the tax disclosure, stating that a replacement of LIBOR could result in a significant modification.

If the LIBOR replacement provision is triggered and it is a modification under reg. section 1.1001-3, the tax adviser's final analysis is whether the modification is significant. As discussed, reg. section 1.1001-3(e) sets forth multiple tests for whether a modification is significant. A replacement of a floating rate for a VRDI should be tested under the change-in-yield test. Even if we have a modification with our replacement, the replacement does not result in a change in yield if the annual yield on the new instrument differs from the annual yield of the LIBOR rate by no more than the greater of (1) 0.25 percent or (2) 5 percent of the annual yield of the LIBOR rate. Assuming both the old debt and the modified debt are VRDIs, the yield test is run using a fixed rate substitute. If compounded SOFR plus an adjustment in step 2 or the rate picked by the calculation agent precisely replicate LIBOR as intended, there will be no change in yield.

Note that there is not a significant disparity between overnight LIBOR and SOFR: Overnight LIBOR was 2.09 percent on September 3, and SOFR was 2.17 percent.[40] However, in September the tax adviser does not know whether the LIBOR replacement provisions will result in a significant change in yield. Therefore, he or she might assume that the LIBOR replacement rate with an

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[39] The option exception in reg. section 1.1001-3(c)(2)(ii) covers "an option provided to an issuer or holder." It does not say "to an issuer or its agent." In other contexts, IRS guidance refers to a taxpayer or its agent. *See, e.g.*, Notice 2015-74, 2015-46 IRB 663, referring to a taxpayer or the taxpayer's designee (defined to include the taxpayer's agent under principles of agency law, among other things).

[40] For overnight LIBOR, see Global-Rates.com, "LIBOR — Current LIBOR Interest Rates"; for SOFR, see Federal Reserve Bank of New York, "Secured Overnight Financing Rate Data." This comparison is somewhat erroneous, of course, because overnight LIBOR is not a frequently referenced rate.

adjustment could result in a change in yield within the meaning of the regulations.

3. Other considerations for replacement.

a. Withholding taxes.

First, note that if there is a significant modification to a debt instrument upon the replacement of LIBOR, any gain or loss on the deemed exchange will generally be foreign-source to non-U.S. investors and therefore generally not be subject to U.S. withholding tax.

Next, it is anticipated that LIBOR will be a higher rate than SOFR, because SOFR is a secured financing rate.[41] An issuer might make up the difference by increasing the spread on the instrument or making a one-time payment to compensate for the expected value of the difference. What is the character of such a one-time payment?

If the replacement of LIBOR results in a significant modification, for tax purposes the one-time payment may be treated as (1) additional consideration in the deemed exchange, (2) interest, or (3) something else. Assuming the issuer is domestic, a non-U.S. investor would generally not be subject to withholding tax on the payment if it is treated as consideration or interest (provided that, in the case of interest treatment, the investor otherwise qualified for the portfolio interest exemption). When there is no significant modification, if the one-time payment is not treated as interest, some non-U.S. investors receiving that payment might be subject to withholding.

b. Grandfathering.

First and most importantly, a deemed reissuance of a foreign-targeted bearer debt instrument may cause that instrument to lose its grandfathered status as a bearer debt instrument sold under the old 1982 Tax Equity and Fiscal Responsibility Act C or D "arrangements reasonably designed to ensure sale to non-U.S. persons."[42] This would lead to several unpleasant U.S. tax consequences, including a potential section 4701 excise tax (1 percent of the debt instrument's principal amount multiplied by the years remaining to maturity), loss of the issuer's interest deduction, and loss of the portfolio interest exemption.

Second, until the term "foreign passthrough payment" is defined in applicable Treasury regulations, instruments issued by non-U.S. issuers are grandfathered from any withholding tax under the Foreign Account Tax Compliance Act on foreign passthrough payments.[43] If there is a significant modification and an instrument is deemed to be reissued, that instrument could lose its grandfathered status.

Third, a deemed reissuance could also take an instrument out of grandfathered status for purposes of section 871 and its regulations for similar reasons.[44]

c. REMIC considerations.

There are two key considerations in the real estate mortgage investment conduit space. First, for an entity to qualify as a REMIC, its regular interests must be issued on the start-up day with fixed terms.[45] Absent IRS guidance that a replacement of LIBOR is not a significant modification, if a REMIC regular interest has mechanics to change its reference rate from LIBOR to something else, there is a risk that the regular interest could be viewed as being issued without fixed terms. Moreover, even if the IRS issues guidance that the replacement of LIBOR is not a section 1001 event, it's not completely clear

[41] *See* ARRC white paper, *supra* note 38.

[42] The Hiring Incentives to Restore Employment Act of 2010 repealed the "foreign targeted" exception for bearer debt instruments, but this repeal did not affect instruments issued on or before March 18, 2012. Of course, it is unlikely that an instrument issued before March 2012 would have LIBOR fallback provisions, but this consideration is too important not to mention.

[43] Under reg. section 1.1471-2(b)(2)(i)(B), any obligation that is executed on or before the date that is six months after the date on which final regulations defining the term "foreign passthrough payment" are filed with the *Federal Register* is grandfathered from FATCA withholding on foreign passthrough payments.

[44] Until January 1, 2021, some instruments are grandfathered from section 871(m) and its regulations if those are not delta one on the date of issuance. Notice 2018-72, 2018-40 IRB 522.

[45] Section 860G(a)(1). A detailed discussion of the REMIC qualification rules is beyond the scope of this report.

that a regular interest will be viewed as having fixed terms if there is a LIBOR replacement mechanic.

The second consideration is that regular interests of the REMIC are permitted to have only specified contingencies, including remote contingencies.[46] Fallback language specifying a fallback rate could cause a regular interest to fail this requirement even though the contingency is to switch to an economic equivalent of LIBOR.

B. Rate Considerations/Alternative Treatments

1. Original issue discount.

The tax adviser considering our medium-term note program also must figure out whether the addition of the ARRC FRN recommendation LIBOR replacement provisions means there will be OID on the notes. When an instrument pays interest at a single QFR within the meaning of the regulations, no stated interest is considered to be OID. This is the reason a straight LIBOR floater usually does not have OID.

A rate is a QFR if variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds in the currency in which a debt instrument is denominated.[47] There is an example in the regulations that confirms LIBOR is a QFR.[48]

The first problem is that under the ARRC FRN recommendations one doesn't know exactly which rate will replace LIBOR. Certainly, SOFR would meet the QFR definition. Compounded SOFR would likely meet the QFR definition as well, because it measures the cost of newly borrowed funds over the immediate past. However, when we get to step 5 in the ARRC FRN recommendation waterfall, the issuer or its designee decides the replacement rate with due consideration for any then-industry-accepted rate. Although one assumes this rate will be a QFR, one cannot be sure because one doesn't know what the rate is. If the rate is not a QFR, the instrument would be treated as a contingent payment debt instrument, as described later.

Assuming the tax adviser overcomes this hurdle, there is still the question of how OID on the note should be calculated. When an instrument provides for interest at two or more QFRs, the VRDI regulations require that each QFR be converted to a fixed rate substitute that equals the value of the QFR on the testing date. If one fixed rate substitute exceeds the other by more than a de minimis amount, the excess will be treated as OID.[49] Note that the regulations provide that if two QFRs can reasonably be expected to have approximately the same value throughout the term of the debt instrument, the instrument is treated as having one QFR.[50]

Here, again, we don't know what the replacement rate will be. Although we can surmise that it will not be that much different from LIBOR, we do not know for sure. Accordingly, converting the replacement rate to a fixed rate substitute is simply impossible.

Another uncertainty about the ARRC FRN recommendations is whether all the replacement rates will be "fresh" under the VRDI regulations. Reg. section 1.1275-5(a)(4) thus provides that the debt instrument must provide that a QFR (or objective rate) in effect at any time during the term of the instrument be set at a current value of that rate. A current value is the value of the rate on any day that is no earlier than three months before the first day on which that value is in effect, and not later than one year after that first day. For a compounded SOFR, if a party tries to replicate a term rate by taking the simple average or compounded SOFR over a period before the debt instrument's issue date, the definition might pose a problem.

For example, say a debt instrument issued on July 1, 2019, pays interest semiannually and the issuer wants to create a six-month compounded SOFR by averaging the daily SOFR values for the six-month period before the rate takes effect.[51] For

[46] *See* reg. section 1.860G-1(a)(5) and (b)(3).

[47] Reg. section 1.1275-5(b)(1).

[48] *See* reg. section 1.1275-5(d), Example 1. Perhaps IRS guidance can replace this example with SOFR or the new market standard when one emerges, although this would probably be far down the government's to-do list.

[49] Reg. section 1.1275-5(e)(3).

[50] Reg. section 1.1275-5(b)(1).

[51] According to the ARRC, all SOFR issuances to date have used an in-arrears framework using SOFR rates over the applicable interest period rather than over a prior interest period (in advance). ARRC, "ARRC SOFR Floating Rate Notes Conventions Matrix" (Aug. 2019).

the interest period beginning January 1, 2020, SOFR values from July 1, 2019, to December 31, 2019, would be used. However, the use of SOFR values before October 1, 2019, might pose a problem under this definition. Of course, another way to look at it is that the rate isn't determined until the last day of the averaging period (that is, December 31, 2019). With that view, the rate will always meet the "three months back" test.

2. Contingent payment debt instrument?

The tax adviser now sees that there are a couple ways the ARRC recommendations could result in the debt instrument being treated as a contingent payment debt instrument. The first is described in the previous section: It is not known that all replacement rates will be QFRs. The second is the adjustment that accompanies all the replacement rates. The amount of the adjustment is not known today; it will be determined if and when LIBOR is replaced. The adjustment can either be a spread added to the fallback rate or take the form of a one-time payment. Should the existence of the potential for a one-time payment cause the instrument to be treated as a contingent payment debt instrument? Under reg. section 1.1275-4, a contingent payment debt instrument is generally any instrument that has a payment subject to a contingency, unless the instrument fits within one of several exceptions. The potentially relevant exceptions for our purposes are (1) the exception for VRDIs, (2) the exception for debt instruments that have one payment schedule that is "significantly more likely than not to occur,"[52] and (3) the exception for debt instruments that provide a fixed yield.[53] Alternatively, the tax adviser can conclude the contingency is "remote or incidental."[54]

Regarding the exceptions, is there one payment schedule that is "significantly more likely than not to occur?" It is still unknown whether or exactly when LIBOR will cease to be published, and therefore there are several different payment schedules estimating the time of the reference rate replacement amount. It is therefore hard to see how the instrument could fit into the exception for debt instruments that provide a fixed yield, because neither the post-LIBOR payment stream nor the value of the one-time payment can be determined on the issue date (thus potentially creating many payment schedules). Alternatively, the tax adviser can conclude the contingency is "remote or incidental.[55]

C. Implications for Tax Disclosures?

How might the above considerations affect the market standard tax disclosure for various structures?

Suppose that a tax adviser is preparing the September 2019 prospectus and indenture in our earlier example. The tax adviser has now puzzled through and flagged the risks, and it is time to decide what to do about it, if anything. Depending on whether proposed regulations have been released and the content of those regulations (which, as discussed, are expected soon), one approach is to include a short paragraph on this point, either as a risk factor or in the tax disclosure, stating that a replacement of LIBOR could result in a significant modification (and, of course, as tax disclosures often do in instances of uncertainty, inform the investor that she should consult her own tax adviser). Whether that disclosure is necessary generally depends on whether the risk is material to investors.[56] If the terms of a particular instrument do not fit squarely within the forthcoming regulations, any disclosure for such instrument might take the approach of disclosing the risk.

As noted, some industries, such as the CLO industry, already include in their disclosures market standard language about the potential tax consequences of the replacement of LIBOR.

[52] Reg. section 1.1272-1(c). The precise test is whether the debt instrument, based on all the facts and circumstances as of the issue date, had a single payment schedule that was "significantly more likely than not to occur." In this case, the yield and maturity of the debt instrument are computed based on this payment schedule.

[53] Reg. section 1.1272-1(d). The precise test is whether all possible payment schedules under the terms of the instrument result in the same fixed yield. In this case, the yield is the fixed yield.

[54] Reg. section 1.1275-4(a)(5).

[55] Reg. section 1.1275-4(a)(5).

[56] *See Basic Inc. v. Levinson*, 485 U.S. 224 (1988). Under this authority, a risk is material to an investor if there is "a substantial likelihood that a reasonable shareholder would consider it important."

IV. Hope for IRS Guidance

Given the potential widespread tax impact of the replacement of LIBOR, many expect the IRS to issue guidance on this issue. That expectation is realistic — as discussed, the Office of Management and Budget's Office of Information and Regulatory Affairs is currently reviewing a set of proposed regulations that will likely come out soon. The questions are what form the proposed regulations will take and what they will cover.

A historical example of such guidance comes to mind. When the euro was introduced in 1999, many instruments denominated in various currencies were converted to reference the euro. That event is factually comparable to the replacement of LIBOR, given the number of instruments affected if the switch to the euro had caused a significant modification. Treasury and the IRS responded by promulgating reg. section 1001-5, which provides that the conversion to the euro was not a taxable event under section 1001.

Various groups have already sent requests to Treasury and the IRS asking that some of the concerns discussed earlier in this report (see Section III.A and B) be addressed by guidance. Groups that have sent comment letters include the ARRC itself,[57] the Structured Finance Industry Group (SFIG), and the Real Estate Roundtable.[58]

All the groups argued that LIBOR replacements should not constitute significant modifications, although the precise recommended approaches differed. The ARRC asked for broad guidance that the following not be treated as significant modifications: (1) modifications to fallback provisions as well as to the referenced rate, (2) replacement of global IBORs as well as the U.S. dollar LIBOR, (3) replacement of replacement rates that include SOFR and potentially any QFR, and (4) modifications when the change in rate or fallback provision is compensated through spread adjustments or a one-time payment.

The SFIG requested broad guidance that the replacement of LIBOR not be treated as an exchange under section 1001. The Real Estate Roundtable asked for guidance providing that (1) when a new agreement conforms to regulatory, governmental, or broad industry consensus on the next market standard rate, the replacement of LIBOR not be treated as a significant modification; and (2) in other cases, if the parties' agreed-on replacement is selected in good faith with the principal purpose and effect of replacing LIBOR with an index or formula selected to preserve the parties' original commercial agreement, that replacement not be a significant modification.

The ARRC also requested guidance clarifying that a debt instrument that references an IBOR and has replacement mechanics be treated as having a single QFR (to address the concern discussed in Section III.B.1).

The ARRC and SFIG both asked for guidance stating that the replacement of LIBOR would not cause a REMIC regular interest to be treated as not having fixed terms on the REMIC's start-up day. The ARRC also asked for guidance that a regular interest that refers to an IBOR and contains a fallback provision providing for an alternative risk-free rate will not fail to have a QFR merely because it is not remote that the interest will be calculated on the new rate once the IBOR is no longer published.[59]

The ARRC recommended that Treasury and the IRS issue guidance providing that any one-time payment be treated as having the same character as the other payments made on the instrument for withholding tax purposes.

Finally, the ARRC drafted proposed regulations generally implementing its positions.[60] The effective date for those regulations is July 27, 2017 (the date on which the U.K. Financial Conduct Authority announced it would not persuade or compel banks to contribute to LIBOR after 2021).

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[57] ARRC white paper, *supra* note 38.

[58] Also, the National Association of Bond Lawyers submitted comments asking that guidance for the replacement of LIBOR be added to the 2019-2020 priority guidance plan.

[59] The ARRC white paper, *supra* note 38, notes that without this guidance there is uncertainty whether any newly formed REMIC can issue a regular interest that refers to a LIBOR, because the reality that the IBORs will cease to be published must be addressed in the instrument.

[60] ARRC, "Proposed Guidance With Respect to LIBOR Transition — 1001 and 863."

V. Conclusion

Uncertainty surrounding a change as massive as the replacement of LIBOR is rare. We are in a transition period in which any number of things could happen. Moreover, although guidance from Treasury and the IRS on LIBOR replacement is expected soon, there is no guarantee of what that guidance will say. For example, will the guidance bless the replacement of LIBOR only when the replacement is made using the ARRC-recommended waterfall? This would leave many instruments out in the cold. In all cases tax advisers should consider the implications of the replacement of LIBOR as we navigate through the transition period to our expected breakup. ■