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Legal Update

Federal LIBOR Legislation Signed Into Law; Amends Section 316(b) of the Trust Indenture Act of 1939

The "Economic Continuity and Stability Act," which includes as Division U the "Adjustable Interest Rate (LIBOR) Act," was enacted on March 15, 2022. The Adjustable Interest Rate (LIBOR) Act ("AIRLA") will affect all US dollar LIBOR ("LIBOR") contracts regardless of governing state law, and will also pre-empt state LIBOR statutes, such as Article 18-C of the New York General Obligations Law ("Article 18-C").[1]

AIRLA operates similarly to Article 18-C, but is necessarily broader in scope. For example, LIBOR floating rate preferred stock, which is generally governed by Delaware law and not affected by Article 18-C, is subject to AIRLA. Section 102(b)(1) of AIRLA also specifically states that it is not intended to prevent the use of any appropriate benchmark rate in new contracts, which seems to specifically support the use of new rates other than the secured overnight financing rate ("SOFR").

This article discusses the effect of AIRLA on LIBOR floating rate notes ("FRNs"). AIRLA is broad and covers all LIBOR contracts, which includes not only FRNs, but consumer loans, student loans, mortgages and other LIBOR-based contracts.

Similar to the operation of Article 18-C, AIRLA provides a solution for existing "legacy" FRNs that have inadequate fallback provisions, based on the 2006 ISDA Definitions or otherwise. The polling provisions in these legacy FRNs will fail once LIBOR is no longer published and, without an external solution, the FRNs would become fixed rate notes, with the last LIBOR setting applying until maturity.

Under Section 104 of AIRLA, after June 30, 2023, the polling provisions in these legacy FRNs will be disregarded and the "Board-selected benchmark replacement" (a rate based on SOFR plus a Board-specified tenor spread) will replace LIBOR.[2] AIRLA preserves any cap, floor, modifier or spread adjustment included in the FRN where SOFR replaces LIBOR.[3] By its terms, AIRLA will not affect existing FRNs that already include robust fallback provisions to, for example, SOFR (under the Alternative Reference Rates Committee's ("ARRC") recommended fallback provisions) or FRNs that give authority to a "determining person" to choose an industry standard replacement rate, as was common prior to the general usage of the ARRC-recommended fallback provisions.[4] A "determining person," as defined in Section 103(10) of AIRLA, would include a calculation agent or other person identified in a FRN as having the "authority, right, or obligation … as identified in the LIBOR contract …

to determine a benchmark replacement." In many of the FRNs issued prior to the general adoption of the ARRC-recommended fallbacks, the determining person might be the issuer, an affiliate of the issuer, a calculation agent or an investment bank appointed by the issuer.

Section 104(c) of AIRLA states that the determining person may select SOFR as the replacement rate and, if so, such selection shall be irrevocable, made by the earlier of the first London banking day after June 30, 2023, and any other date specified in the FRN, and will be used in the FRN after such date.[5] Under Section 104(c)(3) of AIRLA, if the determining person does not select any replacement rate for LIBOR in that timeframe, then SOFR shall automatically apply to the FRN after June 30, 2023. If SOFR is the replacement rate for a FRN, all benchmark conforming changes shall become an integral part of the FRN, and no consent of any FRN holder shall be required prior to the adoption of such benchmark conforming changes.[6]

AIRLA allows parties to a LIBOR contract to specify that AIRLA does not apply to the contract, although it is hard to imagine a FRN containing such a provision at this point. Also, FRNs that specify a fallback rate not based on LIBOR, such as the prime or Federal funds rate, are not altered or impaired by AIRLA.[7]

Section 105 of AIRLA contains continuity of contract and safe harbor provisions, under which a replacement of LIBOR by SOFR, whether by operation of the statute or choice of the determining person, and any benchmark replacement conforming changes, shall constitute:

- A commercially reasonable replacement for, and a commercially substantial equivalent to, LIBOR;
- A reasonable, comparable, or analogous rate, index, or term for LIBOR;
- A replacement that is based on a methodology or information that is similar or comparable to LIBOR; and
- Substantial performance by any person of any right or obligation relating to or based on LIBOR.[8]

The statute also protects determining persons in their choice of SOFR as a replacement for LIBOR, and the performance of the benchmark replacement conforming changes, in that such choice or performance shall not be deemed to impair or affect the right of any person to receive a payment, or to affect the amount or timing of such payment, under any FRN, nor shall any such actions by the determining person have the effect of discharging or excusing performance of the FRN, giving any person the right to unilaterally terminate or suspend performance of the FRN, constitute a breach of any FRN or void or nullify the FRN. Determining persons are also specifically protected against suits, or liability for damages, due to the selection of SOFR to replace LIBOR, or implementing or determining benchmark replacement conforming changes for FRNs. The selection or use of SOFR to replace LIBOR shall not be deemed an amendment or modification of any FRN, or prejudice, impair, or affect the rights, interests or obligations of any person with respect to such FRNs.[9] These protections do not apply if a rate other than SOFR is the replacement rate.

Despite the pronounced "tilt" of AIRLA toward the use of SOFR to replace LIBOR, the statute contains a "no negative inference" provision. Under Section 105(e) of AIRLA, the statute may not be construed to create any negative inference or negative 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 the historical differences between LIBOR and the benchmark replacement) that is not [derived from SOFR]; or any changes, alterations, or modifications to or with respect to a LIBOR contract that are not benchmark replacement conforming changes."

With respect to legacy FRNs with a discretionary replacement provision, if the determining person were to choose a replacement other than one based on SOFR, AIRLA could not be used to question the validity or enforceability of the FRN. However, AIRLA's continuity of contract and safe harbor provisions would not apply in that situation. Also, the choice by a determining person of a rate other than SOFR would not have AIRLA's protections against being questioned as an amendment or modification to the FRN, or possibly being viewed as having prejudiced, impaired, or affected the rights, interests or obligations of the holders.

AIRLA also has a protective provision for banks initiating new "loans," which does not include FRNs, based on rates other than SOFR. Section 106 of AIRLA limits the ability of bank regulators to take enforcement action against any bank based solely on the use of a benchmark other than SOFR in a loan.

AIRLA will have no effect on floating rate notes based on the constant maturity swap rate, or "CMS." 3-month LIBOR is an element of the CMS rate, but the CMS rate does not fall within AIRLA's definiton of LIBOR.

One of the issues for FRNs not effectively addressed in Article 18-C was the conflict between Article 18-C and the Trust Indenture Act of 1939 (the "TIA"). This issue could arise if the last LIBOR setting for a legacy FRN was higher than the sum of the replacement by SOFR and the applicable spread. In such a case, a plaintiff could show harm and claim that his or her right to receive interest was impaired or affected without his or her consent. Although Article 18-C attempted to address this situation by including provisions whereby a replacement of LIBOR with SOFR and applying benchmark replacement conforming changes would not be deemed to impair or affect the right of any person to receive a payment,[10] a state statute cannot preempt a federal law.

Section 104 of AIRLA solves this problem by amending Section 316(b) of the TIA, adding to that Section a new subsection (3), stating that "the right of any holder of any indenture security to receive payment of the principal and interest on such indenture security shall not be deemed to be impaired or affected by any change occurring by the application of section 104 of [AIRLA] to any indenture security."

This is another incentive to use SOFR as the replacement rate for LIBOR, as the use of any other replacement rate would not have the protection provided by amended Section 316(b).

For more information about the topics raised in this Legal Update, please contact any of the following lawyers.

Bradley Berman
+1 212 506 2321
bberman@mayerbrown.com

Jerry Marlatt
+1 212 506 2539
jmarlatt@mayerbrown.com

Anna Pinedo
+1 212 506 2275
apinedo@mayerbrown.com

ENDNOTES

[1] See Section 107 of AIRLA (Preemption).

[2] See Section 104(a) of AIRLA. A "Board-selected benchmark replacement" is defined as a "benchmark replacement identified by the [Board of Governors of the Federal Reserve System] that is based on SOFR, including any tenor spread adjustment pursuant to section 104(e)." Under Section 104(e) of AIRLA, on the first London banking day after June 30, 2023, the Board of Governors of the Federal Reserve System "shall adjust the Board-selected benchmark replacement for each category of LIBOR contract that the Board may identify to include the relevant tenor spread adjustment."

[3] See Section 104(f)(4) of AIRLA.

[4] We discuss the ARRC-recommended fallback provisions in our Legal Update, available at: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/05/arrcs-final-recommendations-for-new-fallbacks-for-libor-floating-rate-notesconverted.pdf

[5] In the event that a determining person chose a replacement rate other than SOFR, Section 104(c) will not apply.

[6] Section 104(d) of AIRLA. "Benchmark replacement conforming changes" apply only in the context of SOFR replacing LIBOR; the definition does not contemplate the use of any other benchmark as the replacement rate. See Section 103(4) of AIRLA.

[7] See Section 104(f)(2) of AIRLA.

[8] Section 105(a)(1)-(4) of AIRLA. These protections do not apply if SOFR is not the replacement rate.

[9] See Sections 105(b)-(d) of AIRLA.

[10] See Section 18-402(2) of Article 18-C.