

Legal Update

Fed Adopts Final Rule Implementing the Adjustable Interest Rate (LIBOR) Act

On December 16, 2022, the Board of Governors of the Federal Reserve System (the “Board”) adopted final rule 12 C.F.R. Part 253, “Regulation Implementing the Adjustable Interest Rate (LIBOR) Act (Regulation ZZ)” (“Rule 253” or the “Final Rule”).¹ Rule 253 identifies SOFR-based benchmark rates that will replace US dollar LIBOR in certain financial contracts after June 30, 2023. Rule 253 will become effective 30 days after its publication in the Federal Register.

Background

On March 5, 2021, the UK Financial Conduct Authority (the “FCA”), which regulates the administrator of the London Interbank Offered Rate (“LIBOR”), announced that all remaining tenors of US dollar (“USD”) LIBOR will cease to be published immediately after June 30, 2023.² To address the permanent cessation of USD LIBOR, Congress enacted the Adjustable Interest Rate (LIBOR) Act (“AIRLA”) on March 15, 2022, to provide a federal solution for replacing references to USD LIBOR in existing contracts that either lack, or contain insufficient, LIBOR fallback provisions.³ AIRLA required the Board to issue implementing regulations that would apply to financial contracts that: are governed by US law; will not mature before June 30, 2023; use or contain references to overnight, one-month, three-month, six-month or 12-month USD LIBOR tenors; and have terms which do not provide for the use of a clearly defined or practicable benchmark rate to replace USD LIBOR when it ceases to be published.

In July 2022, the Board proposed regulations and identified five Board-selected benchmark replacement rates based on the secured overnight financing rate (“SOFR”) that would replace USD LIBOR in different categories of USD LIBOR contracts: derivative transactions, contracts where a government-sponsored enterprise is a party, and all other affected contracts that use or reference USD LIBOR.⁴ The Final Rule adopted last Friday is substantially similar to the Board’s July proposal, with certain changes made in response to comments received from the public.

Rule 253

Rule 253 responds to several rulemaking requirements of AIRLA, and resolves some of the remaining questions about how outstanding USD LIBOR contracts will transition to a replacement rate after USD LIBOR ceases

publication on the first London banking day after June 30, 2023 (the “LIBOR replacement date”). In addition to adding some new defined terms not used in AIRLA, Rule 253 does the following:

- identifies SOFR-based Board-selected benchmark replacements for LIBOR contracts that will not mature prior to the LIBOR replacement date and do not contain clear and practicable benchmark replacements;
- identifies certain benchmark replacement conforming changes related to the implementation, administration, and calculation of the Board-selected benchmark replacement;
- expressly indicates that a “determining person” may select the Board-selected benchmark replacement for the relevant type of LIBOR contract, with any applicable benchmark replacement conforming changes;
- expressly provides that the AIRLA’s protections related to the selection or use of the Board-selected benchmark replacement shall apply to any LIBOR contract for which the Board-selected benchmark replacement becomes the benchmark replacement (whether by operation of law or by the selection of a determining person); and
- clarifies that, under AIRLA, Rule 253 pre-empts any state or local law or standard relating to the selection or use of a benchmark replacement or conforming changes.

Definitions

Rule 253 updates some definitions in AIRLA and adds some new ones.

The bold and italicized words below in the definition of “determining person” in Rule 253.2 were added by the rule:

“Determining person means, with respect to any LIBOR contract, any person with the **sole** authority, right, or obligation, including on a temporary basis (as identified by the LIBOR contract or by the governing law of the LIBOR contract, as appropriate) to determine a benchmark replacement, ***whether or not the person’s authority, right, or obligation is subject to any contingencies specified in the LIBOR contract or by the governing law of the LIBOR contract.***” (Emphasis added)

The larger change was made in response to concerns that, if the determining person’s authority to determine a benchmark replacement did not spring into existence until on or after the LIBOR replacement date, the determining person’s actions might be taken too late to be effective. Under the Final Rule, a “determining person” includes a person with the right to select a benchmark replacement rate even if that right would vest only in the future or is subject to some contingency. For instance, if a LIBOR contract authorizes a person to select a benchmark replacement only when LIBOR becomes unavailable or non-representative (*e.g.*, after June 30, 2023), that person, despite not having the *current* authority to select the LIBOR replacement rate now, will still qualify as a determining person that would be able to select the Board-selected LIBOR replacement rate even before the LIBOR replacement date. Thus, the person need not wait until the LIBOR replacement date to exercise its authority. The Board also clarified that a determining person selecting a Board-selected benchmark replacement pursuant to the authority and statutory protections of AIRLA must choose the Board-selected benchmark replacement prescribed by the Board for that contract type, as identified in Rule 253.4.⁵

The “relevant benchmark administrator” for CME Term SOFR is defined as CME Group Benchmark Administration, Ltd. (“CME Group”).

Affected Contracts

Consistent with AIRLA and the proposed version of Rule 253, the following LIBOR contracts (such as USD LIBOR floating rate notes⁶) are subject to Rule 253:

- LIBOR contracts that contain no fallback provisions;
- LIBOR contracts that contain fallback provisions that identify neither a specific benchmark replacement nor a determining person; and
- LIBOR contracts that contain fallback provisions that identify a determining person, but where the determining person has not selected a benchmark replacement by the earlier of the LIBOR replacement date and the latest date for selecting a benchmark replacement according to the terms of the LIBOR contract, for any reason.⁷
 - If a determining person does not elect to use any benchmark replacement, the LIBOR contract will transition to the Board-selected benchmark replacement by operation of law.⁸

For legacy USD LIBOR floating rate notes with fallbacks based on the 2006 ISDA Definitions, AIRLA and Rule 253 will, by operation of law and on the LIBOR replacement date, disregard the fallback provisions and nullify the polling requirements⁹ stated in the terms of the notes, and replace USD LIBOR with the Board-selected benchmark replacement (CME Term SOFR of the same tenor) and the relevant spread adjustment.

These LIBOR contracts are *not* subject to AIRLA:

- any LIBOR contract that the parties have agreed in writing shall not be subject to AIRLA;
- any LIBOR contract that contains fallback provisions that identify a benchmark replacement that is not based in any way on any LIBOR value (including the prime rate or the effective Federal Funds rate), after disregarding any LIBOR- or poll-based fallback provisions; and
- any LIBOR contract as to which a determining person selects a benchmark replacement other than the Board-selected benchmark replacement, again after disregarding any LIBOR- or poll-based fallback provisions.¹⁰

The Final Rule also eliminated the use of the terms “covered contract” and “non-covered contract” originally found in the Proposing Rule, based on feedback from commenters who thought these terms did not fully align with AIRLA’s language and were confusing.

With respect to the determination of a determining person, the Board chose not to impose any notice requirements (*e.g.*, requiring a determining person to provide notice to one or more parties) concerning the determining person’s selection.¹¹

Rule 253.3(d) is a new section not included in the proposed rule, which provides that LIBOR contracts that transition to the Board-selected benchmark replacement generally will not have their other provisions impaired by the rule. Contractual provisions that are specifically preserved include the date for determining a benchmark (subject to certain exceptions), rounding conventions, provisions referencing LIBOR or any LIBOR value prior to the LIBOR replacement date (including any provision requiring a person to look back to a LIBOR value as of a

date preceding the LIBOR replacement date) and provisions applying any cap, floor, modifier or spread adjustment to which LIBOR had been subject pursuant to the terms of a LIBOR contract.

Board-selected benchmark replacements

Rule 253.4 identifies different Board-selected benchmark replacement rates applicable to different categories of LIBOR contracts subject to AIRLA. References in such LIBOR contracts to overnight, one-month, three-month, six-month or 12-month USD LIBOR tenors would be replaced by the applicable Board-selected benchmark replacement rate (*e.g.*, Fallback Rate (SOFR); CME SOFR; 30-day Average SOFR; 90-Day Average SOFR; etc.) plus the relevant spread adjustment specified in AIRLA (*e.g.*, 0.00644 percent for overnight LIBOR, 0.11448 percent for one-month LIBOR, 0.26161 percent for three-month LIBOR, 0.42826 percent for six-month LIBOR and 0.71513 percent for 12-month LIBOR).¹²

CME Term SOFR is a forward-looking term rate administered by CME Group and based on SOFR. CME Group calculates and publishes CME Term SOFR in one-month, three-month, six-month and 12-month tenors.

Benchmark replacement conforming changes

AIRLA authorized the Board to determine any additional technical, administrative, or operational changes, alterations or modifications to LIBOR contracts based on a determination that such changes, alterations or modifications would address one or more issues affecting the implementation, administration and calculation of the Board-selected benchmark replacement in LIBOR contracts (Benchmark replacement conforming changes).¹³ Proposed Rule 253 did not include any such changes, but preserved the Board's authority to implement such changes in the future.

Rule 253 preserves the Board's ability to, in its discretion, publish additional benchmark replacement conforming changes, by regulation or order, and the ability of a "calculating person"¹⁴ to make certain conforming changes with respect to a LIBOR contract that is not a consumer loan, consistent with AIRLA. The rule also specifies certain conforming changes and, consistent with AIRLA, indicates that these conforming changes shall become an integral part of any LIBOR contract for which the Board-selected benchmark replacement replaces the contract's references to LIBOR.¹⁵

Significantly, Rule 253.5(a)(3) provides that a calculating person may make any additional technical, administrative, or operational changes, alterations or modifications that, in that person's reasonable judgment, would be necessary or appropriate to permit the implementation, administration and calculation of the Board-selected benchmark replacement under or with respect to a USD LIBOR floating rate note after giving due consideration to any changes, alterations or modifications otherwise required by the Board, without any requirement to obtain consent from any other person prior to the adoption of such conforming changes.¹⁶

The specified Benchmark replacement conforming changes are:

- Any reference to a specified source for LIBOR (such as a particular newspaper, website or screen) shall be replaced with the publication of the applicable Board-selected benchmark replacement (inclusive or exclusive of the relevant tenor spread adjustment) by either the relevant benchmark administrator for the applicable Board-selected benchmark replacement or any third party authorized by the relevant benchmark administrator to publish the applicable Board-selected benchmark replacement;

- Any reference to a particular time of day for determining LIBOR (such as 11:00 a.m. London time) shall be replaced with the standard publication time for the applicable Board-selected benchmark replacement (inclusive or exclusive of the relevant tenor spread adjustment), as established by the relevant benchmark administrator;
- Any provision of a LIBOR contract requiring use of a combination (such as an average) of LIBOR values over a period of time that spans the LIBOR replacement date shall be modified to provide that the combination shall be calculated consistent with that contractual provision using (i) the applicable LIBOR for any date prior to the LIBOR replacement date and (ii) the applicable Board-selected benchmark replacement rate for any date on or following the LIBOR replacement date, respectively; and
- To the extent a Board-selected benchmark replacement is not available or published on a particular day indicated in the LIBOR contract as the determination date, the most recently available publication of the Board-selected benchmark replacement will apply.¹⁷

Confirmation of AIRLA Safe Harbor Provisions

Rule 253.7 specifically confirms that the AIRLA safe harbor provisions for LIBOR contracts that change over to the Board-selected benchmark replacement, either by operation of law or the choice of a determining person will apply, and that the provisions of Section 105(e) of AIRLA (no negative inference)¹⁸ are not altered or modified by the rule.

Synthetic USD LIBOR

The Adopting Release includes an interesting discussion of the potential effect of synthetic USD LIBOR.

Recently, the FCA issued a consultation on synthetic USD LIBOR (the "Consultation"), in which the FCA sought views on its proposal to require publication of the one-, three- and six-month USD LIBOR settings on a synthetic basis until end-September 2024. According to the FCA, synthetic LIBOR settings "are a fair and reasonable approximation of what LIBOR might have been had it continued to exist, [although] they are not representative of the markets that the original LIBOR settings were intended to measure."¹⁹ Synthetic USD LIBOR is not an interbank offered rate. Synthetic USD LIBOR, as published, would be exactly the same as the Board-selected benchmark replacement and the applicable tenor spread adjustment.²⁰

It appears from the discussion on pages 26-29 of the Adopting Release that some commenters were concerned that the existence of synthetic USD LIBOR might cause a determining person not to be able to choose a replacement rate, such as the Board-selected benchmark replacement, because the triggering event of USD LIBOR unavailability would not occur. This is despite the fact that synthetic USD LIBOR is considered unrepresentative, since some USD LIBOR floating rate notes may not include a non-representativeness trigger.

Synthetic USD LIBOR is designed for floating rate contracts that are not within the purview of AIRLA or Rule 253. An example would be a UK law-governed USD LIBOR floating rate note. Such a security would benefit from the use of synthetic USD LIBOR, depending on the specific fallback provisions of the security.

In the event that a determining person makes the choice of synthetic USD LIBOR as a replacement rate, despite that rate being the same as the Board-selected benchmark replacement, the consequences under AIRLA and Rule 253 would be:

- The safe harbor provisions of Sections 105(a)-(d) of AIRLA would not be available due to the Board-selected benchmark replacement not having been chosen, which also means that any conforming changes would not be Benchmark replacement conforming changes;
 - However, under Section 105(e) of AIRLA, nothing in AIRLA may be construed to create any negative inference or negative presumption regarding the validity or the enforceability of the floating rate note by the replacement of USD LIBOR with a benchmark other than the Board-selected benchmark replacement or the use of changes, alterations or modifications to the floating rate notes that are not benchmark replacement conforming changes;
- Any of the changes to the floating rate note specified immediately above would not constitute “benchmark replacement conforming changes,” as defined in AIRLA and Rule 253 and, under Section 105(d)(1) of AIRLA, would not become part of the floating rate note by operation of AIRLA.
 - Section 104(d)(2) of AIRLA, which provides that no consent of any other person is required if benchmark replacement conforming changes are made, would be inapplicable.

The choice of synthetic USD LIBOR as opposed to the Board-selected benchmark replacement would not be altered or impaired by under Section 104(f)(3) of AIRLA.

Practical Considerations

The Board’s adoption of Rule 253 is a welcome development for market participants in the US debt markets and an important step in the orderly transition away from LIBOR, happening globally. As Congress and the Board observed, LIBOR has been the dominant reference rate used in financial contracts in recent decades and remains in extensive use today, serving as the benchmark rate in more than \$200 trillion worth of contracts worldwide.²¹ A smooth, consistent and uniform transition away from LIBOR would be in the interest of the greater financial community, promote the continuity of financial transactions and prevent disturbances and disruptive litigation related to the discontinuation of LIBOR.

Given the upcoming permanent cessation of the remaining USD LIBOR tenors immediately after June 30, 2023, issuers, advisors and market participants are reminded that the time to assess and review their existing LIBOR-linked financial contracts is now. Issuers should identify those LIBOR-linked contracts maturing beyond the LIBOR replacement date, assess whether the legislative solution afforded by AIRLA and Rule 253 would be applicable and, if so, weigh whether reliance on such outcomes would be sufficient or desirable given their particular situation.

- For instance, issuers should remember that their financial contracts that are governed by non-US law, or that contain non-USD LIBOR benchmark reference rates, or contain USD LIBOR tenors other than the overnight, one-month, three-month, six-month or 12-month, USD LIBOR, will not be covered by AIRLA and Rule 253. Accordingly, they would not be able to rely on the remedies and safe harbors afforded therein for these contracts, and would have to explore other remedies outside of the legislative solution.
- As another example, AIRLA provides that nothing therein shall be construed to impair the right of parties to enter any written agreement specifying that a LIBOR contract shall not be subject to the terms of AIRLA. Parties who prefer to use an alternative benchmark rate other than the Board-selected benchmark replacement rate based on SOFR and the AIRLA-specified spread adjustment are generally

able to do so, provided that the terms of their contracts allow for such alternative and assuming that such arrangement is timely adopted and does not run afoul of any applicable provisions of AIRLA.

Regarding the application of AIRLA and Rule 253 to their contracts, issuers should closely examine whether the terms of their contracts contain no or inadequate fallback provisions, or contain fallback provisions that identify neither a specific benchmark replacement nor a determining person that would be authorized to select a benchmark replacement rate. Pay particular attention to the fallback provisions of the contract that AIRLA and Rule 253 say should be disregarded, as well as fallback provisions relating to the determining person's authority to designate a benchmark replacement rate.

- For instance, if a LIBOR contract specifies the last published LIBOR value will be used if LIBOR is not published (as is commonly found in USD LIBOR floating rate notes), but contains no other fallback provisions, then, pursuant to Rule 253.3(a)(2), such language would be disregarded as of the LIBOR replacement date. As a result, on the LIBOR replacement date, the LIBOR contract would be treated as having no fallback provisions and would transition to the Board-selected benchmark replacement under the Final Rule.²²
- Importantly, note that Rule 253 now defines a "determining person" to include a person with the right to select a benchmark replacement rate even if that right would vest only in the future or is subject to some contingency. Hence, if a LIBOR contract authorizes a person to select a benchmark replacement only when LIBOR becomes unavailable or non-representative (e.g., after the LIBOR replacement date), that person need not wait until the LIBOR replacement date to exercise its authority to select the Board-selected LIBOR replacement rate.

Finally, there are some unresolved issues relating to other financial contracts that are not LIBOR-linked and hence not covered by AIRLA and Rule 253. In particular, the constant maturity swap ("CMS") rate with a floating rate leg based on USD LIBOR, which will cease publication after the LIBOR replacement date, is not affected by AIRLA or Rule 253.²³ CMS rate floating rate notes with inadequate fallback provisions may have to be addressed by tender or exchange offers, or possibly consent solicitations. Nor do Rule 253 and AIRLA address volatility control indices that include a cash element based on USD LIBOR, as those indices are also not LIBOR contracts.

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Endnotes

- ¹ See the Board's [adopting release for Rule 253](#) (the "Adopting Release").
- ² See "[FCA announcement on future cessation and loss of representativeness of the LIBOR benchmarks](#)" (March 5, 2021).
- ³ Pub. L. 117-103, div. U, codified at 12 U.S.C. 5801 *et seq.* AIRLA was included in the [Consolidated Appropriations Act, 2022](#). See Division U at pages 777-786.
- ⁴ See the Board's [proposing release](#) (the "Proposing Release").
- ⁵ See the Adopting Release, *supra* note 1, at 19.
- ⁶ AIRLA and Rule 253 have a much broader scope than just USD LIBOR floating rate notes, as AIRLA and Rule 253 affect all "LIBOR contracts," as defined therein. This alert provides a general discussion of AIRLA and Rule 253 applicable to LIBOR contracts, but highlights certain issues relevant to USD LIBOR floating rate notes.
- ⁷ Rule 253.3(a). Floating rate notes with a "determining person" provision generally were issued prior to the [Alternative Reference Rates Committee's \("ARRC"\) publication of recommended USD LIBOR fallback provisions](#) in April 2019.
- ⁸ Rule 253.3(a)(1)(iii); Section 103(c)(3) of AIRLA.
- ⁹ Generally, these are requirements for a person (other than a benchmark administrator) to conduct a poll, survey or inquiries for quotes or information concerning interbank lending or deposit rates.
- ¹⁰ Rule 253.3(b); Section 104(f)(3) of AIRLA.
- ¹¹ See the Adopting Release, *supra* note 1, at 23.
- ¹² Rule 253.4(b)(1)(ii), (c)(3). See Section 103(20) of AIRLA, *supra* note 3.
- ¹³ See Sections 103(4) and 104(d) of AIRLA.
- ¹⁴ Rule 253.2 defines a "calculating person" as any person, including the determining person, responsible for calculating or determining any valuation, payment or other measurement based on a benchmark.
- ¹⁵ See Rule 253.5(a)-(b).
- ¹⁶ This section applies to LIBOR contracts that are not consumer loans.
- ¹⁷ Rule 253.5(b). The last bullet point is subject to exceptions inapplicable to USD LIBOR floating rate notes.
- ¹⁸ Section 105(e) provides that AIRLA cannot be construed to create a negative inference or presumption regarding the validity or enforceability of a benchmark replacement that is not the Board-selected benchmark replacement or any contract modifications that are not benchmark replacement conforming changes, other than the provisions nullifying fallbacks based in any way on LIBOR or requiring bank polling regarding lending or deposit rates.
- ¹⁹ See Sections 1.6 and 1.7 of the [FCA Consultation Paper on 'synthetic' US dollar LIBOR and feedback to CP22/11](#) (November 2022).
- ²⁰ *Id.* at Section 3.45.
- ²¹ See AIRLA, *supra* note 3, section 102(a)(1), at pages 777-778; see Adopting Release, *supra* note 1, at page 2.
- ²² See the Adopting Release, *supra* note 1, at 20.
- ²³ See the [ICE Benchmark Administration announcement](#) of November 14, 2022.