Corporate, Finance and Investments

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What Happened to My Interest Rate? A Deep Dive into Hardwiring Predictability and Fairness for LIBOR Transition in Loans, Derivatives and other Contracts

The U.S. dollar LIBOR interest rate index is the most widely used variable interest rate benchmark in the world, serving as the reference rate for over an estimated $200 trillion of financial products worldwide, and official announcements expected as soon as year-end 2020 of LIBOR's December 31, 2021 demise. Such demise will have far-reaching implications, with the overriding risk being value transfer, whether intentional or inadvertent, from one entity to another (such as a borrower to a lender). In this Client Alert, we provide background on the transition from LIBOR, summarize the guidance and recommendations of the Alternative Reference Rates Committee (the "***ARRC***") and the International Swaps and Derivatives Association ("***ISDA***"), and propose a specific, actionable plan to hardwire automatic LIBOR transition terms in loan agreements and other contracts with LIBOR-based interest rates in a manner that will provide predictability and certainty for all parties, minimize the value transfer resulting from the replacement of LIBOR and minimize basis risk between loans and the derivatives used to hedge such loans.

BACKGROUND

(1) The Transition from LIBOR and the Need for a "Fallback" Reference Rate

When LIBOR ceases to be a representative interest rate index, both existing financial transactions that rely on LIBOR as the reference rate and new financial transactions will need a substitute reference rate (i.e., a "fallback" rate). Our prior Client Alert provided an overview of potential issues arising from such cessation.[1] In this Client Alert, the issues surrounding a suitable substitute reference rate (and the appropriate events that should "trigger" such substitution) are described in more depth.

The end of LIBOR's dominance and availability as a representative index for variable interest rate transactions is near. In 2017, the UK's Financial Conduct Authority (the "***FCA***") announced that it would not require panel banks to make LIBOR submissions after December 31, 2021 and that market participants should not rely on LIBOR's continued availability or reliability after such date.[2] LIBOR's pending demise is the result of many factors: notably, LIBOR is based upon a relatively small amount of actual transactions (a daily trading volume of approximately $500 million) and it has been subject to well-publicized manipulation.

If LIBOR ceases to be available, LIBOR-based loans will, in many cases, accrue interest at the higher of the federal funds rate (plus 0.50% per annum) or the applicable "prime rate", with the net effect of imposing a materially higher interest rate on borrowers (approximately 3.00% per annum). In a prior Client Alert, we identified this potential transfer of value to lenders and proposed a solution to minimize the unintended value transfer that might otherwise occur.[3] In addition, interest at the higher rate could result in events of default arising from breaches of interest rate hedging covenants and/or the failure to satisfy debt service or interest rate coverage ratios—outcomes that both borrowers and lenders would generally view as unintended and unfortunate. Moreover, legacy derivatives transactions would cease to be effective interest rate hedges on outstanding LIBOR loans. For example, legacy derivative transactions governed by the 2006 ISDA Definitions typically provide that, if LIBOR is unavailable, a replacement reference rate is determined through a dealer poll, which is a mechanism primarily designed to address a short-term disruption in the publication or availability of LIBOR (as opposed to its permanent unavailability or LIBOR's failure to be representative). Consequently, the application of the "fallback" reference rate under the 2006 ISDA Definitions would be impractical, yielding at best inconsistent results, or may be impossible to implement in the event of LIBOR's cessation. In any event, the application of the "fallback" reference rate under the 2006 ISDA Definitions will not provide parties with comfort that formerly LIBOR-based loans are properly hedged and the resulting "mismatch" will (among other things) impact borrowers' hedge accounting and financial statements.

Thankfully, market participants are aligned to work together to come to a uniform and workable solution before LIBOR ceases to be available as a representative reference rate. The financial services industry and its regulators, among others, is addressing the issue in a concerted effort in both the cash market and the derivatives market. However, the two approaches unfortunately vary in ways that could trip-up or confuse even savvy market participants.

In 2017, the Federal Reserve Board and the Federal Reserve Bank of New York re-convened the ARRC (which first met in December 2014) with a wider segment of market participants to address the transition from LIBOR to an alternate representative reference rate. A broad array of over 300 private-market participants comprise the ARRC, including banks, asset managers, insurers and industry associations (such as ISDA and the LSTA). The ARRC published guidelines setting forth recommended contractual provisions and commentary on April 25, 2019[4] and June 30, 2020[5] (hereinafter the "***2019 ARRC Recommendations***" and the "***2020 ARRC Recommendations***", respectively). These guidelines not only address the use of a fallback rate in loans, but also set forth recommendations and guidance for other financial products which may have feature rates benchmarked to LIBOR.[6] The efforts of the ARRC to address LIBOR transition generally focus on the cash market (such as credit agreements and loan agreements). The ARRC's recommended approach is summarized below.

Whereas the ARRC's efforts focus on cash markets, ISDA's efforts to address LIBOR transition focus on derivatives markets. ISDA has a long and successful history of adopting market-wide reforms in response to various regulatory and market developments, such as Dodd-Frank. ISDA's anticipated recommendations are also summarized below.

(2) The ARRC's Recommendations: The "Amendment" Approach and the "Hardwired" Approach

The ARRC was tasked with identifying an alternative reference rate in substitution for LIBOR, creating an implementation plan for the voluntary adoption of such rate and identifying best practices for contractual language. The ARRC selected the Secured Overnight Financing Rate ("***SOFR***") as the alternate rate.

SOFR (rhymes with gopher) is different than LIBOR in several important respects. Whereas LIBOR purports to reflect the unsecured rate at which banks borrow money in an interbank market based on the expert judgment of a bank panel (whose judgment is informed by a relatively small volume of daily transactions), SOFR is a secured rate that is administered by the Federal Reserve and reflects the cost of borrowing money using U.S. Treasuries as collateral. SOFR is based on a wide and deep pool of actual market transactions. In addition, whereas LIBOR features various interest periods (for example, 1-month LIBOR, 3-month LIBOR, etc.), SOFR itself is a daily rate.

The 2019 ARRC Recommendations contain both an "amendment" approach and a "hardwired" approach for the replacement of LIBOR as an index for interest rates in floating-rate loan agreements. The "amendment" approach sets forth a streamlined process by which, upon the occurrence of certain pre-determined trigger events, the borrower and the administrative agent may negotiate an amendment to substitute a new interest rate index (and any applicable adjustments that may be necessary to facilitate equivalency with LIBOR), giving due consideration to regulatory recommendations and market conventions, with such amendment becoming effective upon the posting of the amendment to the lenders (subject to the majority lenders' right to object within a specified time period and subject, in certain circumstances, to the approval of the majority lenders). Certain trigger events are based on the cessation of LIBOR, while other trigger events are based on "pre-cessation" events, such as the FCA making a public statement that LIBOR is "no longer representative".[7]

Whereas the "amendment" approach is open-ended and generally gives borrowers and administrative agents flexibility to amend the applicable loan agreement to reflect a substitute interest rate (and any applicable equivalency adjustments), the ARRC's "hardwired" approach provides certainty and obviates the need for any material future amendment. Under the "hardwired" approach, LIBOR is replaced upon the occurrence of certain trigger events with a substitute interest rate index that is selected from a pre-determined "waterfall" of rates based on the availability of such rates at the time of such trigger event (with each rate being subject to equivalency adjustments to equate economically to LIBOR).

The 2020 ARRC Recommendations include an updated "hardwired" approach and strongly encourage market participants to use the "hardwired" approach on and after September 30, 2020. The waterfall for the updated "hardwired" approach under the 2020 ARRC Recommendations contemplates the following: first, "Term SOFR"; second, "Daily Simple SOFR"; and third, the rate that would result from the ARRC's "amendment approach". The aforementioned "equivalency adjustments" are necessary because SOFR (which, unlike LIBOR, is a secured rate and therefore generally lower than LIBOR) requires a positive spread adjustment (i.e., an increase) in order to make it an equivalent substitute for LIBOR. As of the date of this Client Alert, the market is coming to the view that the appropriate spread adjustment for SOFR is equal to the 5-year trailing median difference between LIBOR and SOFR, which is updated daily and reported by Bloomberg. At the time that the substitution of LIBOR occurs under the "hardwired approach", such 5-year trailing median difference will be locked in and no longer updated daily.

As of the date of this Client Alert, there are only a few deals in the market reflecting the "hardwired" approach. In general, banks and other lenders seem to be reticent to embrace the "hardwired" approach until the market evinces a clear move in that direction. Many of our bank and financial institution clients are currently updating their form loan agreements in anticipation of the market's shift to the "hardwired" approach.

The "amendment" approach described above is sub-optimal insofar as the amendment process for substituting a replacement rate for LIBOR commences only after a trigger event has occurred (potentially creating in certain circumstances an interim period where the higher "alternate base rate" would apply), whereas under the "hardwired" approach the replacement rate is automatically substituted for LIBOR upon the trigger event. We are exploring, as set forth below, (i) converting loan agreements with the 2020 ARRC Recommendation's "amendment" approach to the 2020 ARRC Recommendation's "hardwired" approach and (ii) amending loan agreements with LIBOR substitution language that pre-dates the 2019 ARRC Recommendations to reflect the 2020 ARRC Recommendation's "hardwired" approach.

(3) The ISDA Fallback Protocol: An Orderly LIBOR Transition for the Derivatives Market

Whereas the ARRC's efforts focus on the cash market, ISDA's efforts focus on the derivatives market. ISDA has significant expertise with addressing similar market developments (such as implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act). In addition, whereas the ARRC's efforts to address the issue in the cash market are premised upon counterparties entering into amendments for existing loan agreements or including LIBOR substitution language in loan agreements going forward, ISDA has experience implementing changes across legacy derivative transactions through its protocols. An ISDA protocol has the effect of amending all legacy derivatives transactions among and between those parties that elect to adhere to such protocol, obviating the need for bilateral amendments, negotiations or even discussions. That said, some market participants have in the past elected to enter into bilateral agreements rather than relying on the parties' adherence to the applicable ISDA protocol.

On October 23, 2020, ISDA published the IBOR Fallbacks Supplement to the 2006 ISDA Definitions (the "***ISDA Fallback Supplement***") and the ISDA 2020 IBOR Fallbacks Protocol (the "***ISDA Fallback Protocol***").[8] For many parties, the ISDA Fallback Supplement and the ISDA Fallback Protocol will provide an orderly transition from LIBOR for both new and legacy derivatives transactions that use LIBOR as a reference rate, and the ISDA Fallback Supplement and the ISDA Fallback Protocol will offer visibility (and compelling guidance) for many borrowers and lenders in the cash market.

The ISDA Fallback Protocol identifies the "Fallback Rate (SOFR)" as the fallback reference rate that will replace LIBOR. The Fallback Rate (SOFR) is compounded daily SOFR in arrears, meaning that the SOFR rate compounds daily in arrears and therefore the daily rates are not known until the end of the applicable day (like Daily Simple SOFR). The compounding feature is more operationally complex but purports to better account for daily time value of money. We note that using Fallback Rate (SOFR) as the fallback reference rate may pose operational and back-office challenges in cash markets where daily, simple rates are commonly used and where intra-period payments are routine.

The ISDA Fallback Protocol goes into effect on January 25, 2021 and includes trigger effects to "hardwire" the replacement of LIBOR with the Fallback Rate (SOFR). In recognition that certain credit support documents (such as parent guarantees) may by their terms require the consent of the credit support provider party thereto, the ISDA Fallback Protocol includes an undertaking to obtain any such consent.

Whereas the ISDA Fallback Protocol is designed to address legacy derivative transactions, the ISDA Fallback Supplement will incorporate the same solution for future derivatives transactions when it becomes effective on January 25, 2021. That is, all new derivatives transactions using the 2006 ISDA Definitions will, as a result of the ISDA Fallback Supplement, automatically include ISDA's formulation of the fallback to SOFR through their use of the supplemented 2006 ISDA Definitions. Any interest rate exposure under variable interest rate loan agreements on and after January 25, 2021 will need close attention to ensure that substitution of LIBOR under the loan agreement coincides with substitution under interest rate hedges for such loan agreement.

RECOMMENDED APPROACH FOR PREDICTABILITY, ALIGNMENT AND FAIRNESS

In order to minimize any "mismatch" or basis risk between cash borrowings and interest rate hedges, borrowers and their lenders may wish to ensure maximum correlation between the replacement reference rate (together with the applicable reference rate adjustments) for LIBOR in loan agreements and the related derivatives transactions, and may also wish to ensure contemporaneous replacement of LIBOR in such loan agreements and such related derivatives transactions.[9]

As suggested in ARRC's guidance,[10] the foregoing can be implemented as follows: (i) in the derivatives market, market participants should adhere to the ISDA Fallback Protocol and (ii) in the cash market, market participants should "cross-wire" loan agreements to implement the ISDA Fallback Protocol's LIBOR fallback reference rate mechanics in the manner suggested by the ARRC's "hardwired" approach in the 2020 ARRC Recommendations by deleting "Term SOFR" from the reference rate waterfall.[11] The resulting contractual provision will make "Daily Simple SOFR" (plus the corresponding reference rate adjustments) the first option in the replacement reference rate "waterfall" and thereby generally align with the ISDA Fallback Protocol's reliance on the Fallback Rate (SOFR). The 2020 ARRC Recommendations also suggest that Daily Simple SOFR should be subject to a spread adjustment (in order for SOFR, as a secured rate, to better approximate equivalency with LIBOR, an unsecured rate) in the same manner as set forth in the ISDA Fallback Supplement and the ISDA Fallback Protocol (i.e., the 5-year trailing median difference between LIBOR and SOFR, which is updated daily and reported by Bloomberg). At the time that the substitution of LIBOR by the Fallback Rate (SOFR) under the ISDA Fallback Protocol occurs, such 5-year trailing median difference will be locked in and no longer updated daily.

There are a few key differences between the Daily Simple SOFR fallback rate under the 2020 ARRC Recommendations and the Fallback Rate (SOFR) under the ISDA Fallback Protocol and ISDA Fallback Supplement. The Fallback Rate (SOFR) is compounded daily in arrears, whereas Daily Simple SOFR is sourced daily and multiplied by the outstanding principal of the applicable loans. Since both rates are "backward" looking and not known until the end of an applicable period, both the ARRC and ISDA have included "lookback" periods to give lenders time to run calculations and to give borrowers advance notice of the rate during a prior period. The 2020 ARRC Recommendations suggest 5 business days for the lookback period, whereas the ISDA Fallback Protocol and ISDA Fallback Supplement specify 2 business days.

The LSTA has concluded that the basis risk resulting from the aforementioned differences between Daily Simple SOFR and the Fallback Rate (SOFR) is mathematically insubstantial based on historical data and, in our view, the differences may offer some advantage to borrowers because the Fallback Rate (SOFR) under derivatives will be slightly higher than the Daily Simple SOFR under loan agreements, and borrowers would therefore receive the net benefit of daily compounding.[12]

The final portion of our recommendation focuses on timing—a poorly timed solution carries many of the same risks as the failure to implement a solution. While LIBOR is generally expected to remain available as a reference rate until December 31, 2021, it behooves all market participants to address the transition from LIBOR well in advance of that date (i.e., at least 6 months prior). Notably, COVID-19 and related disruptions across the spectrum of industry sectors are not expected to delay the timetable for the cessation of LIBOR.[13] In the cash market, we expect a glut of LIBOR transition-related amendments in the first and second quarters of 2021 and a possible logjam as borrowers and financial instructions alike struggle with the administrative and logistical burden of implementing amendments for all existing credit agreements. Implementing a solution late is better than no solution at all, but lateness may carry adverse consequences such as higher interest rates in the interim period, exposure to basis risk, increased likelihood of defaults or events of default, complications for hedge accounting, and litigation risk if parties dispute the impact of LIBOR cessation under existing agreements (whether loan agreements or other types of contracts).

OTHER CONSIDERATIONS

(1) Avoiding Value Transfer in Other Contracts

The use of LIBOR is not limited to loan agreements and derivatives transactions. A whole host of other contracts may rely on LIBOR as a reference rate for calculating interest—and the transition from LIBOR has the potential for value transfer, whether intentional or inadvertent, in each such contract. It is an area rife with the potential for disputes and litigation. In short, companies will want to address the issue of LIBOR transition not just as "borrowers" under loan agreements or as "parties" to derivatives transactions, but also as parties under commercial agreements generally. In many cases, a task force assembled by a company to handle LIBOR transition may find quickly that the company has many material commercial agreements that rely on LIBOR.

The ARRC's "hardwired" approach is highly portable to other types of contracts. Companies should consider taking steps to identify affected contracts and to amend those contracts as efficiently as possible (e.g., omnibus amendments) to include an acknowledgement and agreement that the parties will automatically replace LIBOR with a different reference rate (similar to the ARRC "hardwired" approach), coupled with "further assurances"- or "cooperation"-type language to work out unaddressed details where necessary.

(2) Technology-Based Solutions

Technology-based solutions to enable the efficient identification and evaluation of LIBOR-related provisions across a company's "library" of contracts are also available through law firms and consultants. King & Spalding LLP has long-standing relationships to bring AI-based solutions to bear for the purpose of identifying contracts with LIBOR issues. In addition, King & Spalding LLP routinely partners with derivatives consulting firms to address related financial models and transition from LIBOR.

For many companies, the legal acumen of a leading law firm coupled with the efficiency of technology may represent the right tools to solve an issue that may otherwise prove intractable. In the context of the transition from LIBOR, a software- and/or AI-based solution could be used to identify, extract and assess LIBOR-related provisions across a company's "library" of contracts and thereby enable a company to make well-informed choices about how best to solve the issue and how best to prioritize implementation of the solution.

(3) Potential Legislative Solution for New York State

In recognition that companies large and small use LIBOR as a reference rate across a gamut of contracts, the ARRC has proposed legislation to the New York State Assembly that would address the transition from LIBOR by "requiring the use of the recommended benchmark replacement where the contract language is silent or the fallback provisions prescribe the use of LIBOR".[14] While the legislation (if made into law) would apply to New York law-governed agreements only, such legislation would likely address a significant percentage of applicable contracts (given the prevalence of New York law as the governing law under many commercial agreements) and it is possible that other states may follow suit.

As described by the ARRC, "the proposed statute would: (1) prohibit a party from refusing to perform its contractual obligations or declaring a breach of contract as a result of the discontinuance of LIBOR or the use of the statute's recommended benchmark replacement; (2) definitively establish that the recommended benchmark replacement is a commercially reasonable substitute for and a commercially substantial equivalent to LIBOR; and (3) provide a safe harbor from litigation for the use of the recommended benchmark replacement".[15]

The ARRC's legislation is aimed at contracts that use LIBOR as a reference rate and lack a fallback to an alternative reference rate, but it would not override "workable" fallback provisions. As described above, many loan agreements feature a fallback to the "alternate base rate" (i.e., the higher of the federal funds rate plus 0.50% per annum or the applicable "prime rate") and the legislation would not help borrowers avoid the value transfer that would result under those loan agreements.

In addition, while the ARRC's proposed legislation has obvious merits, both experienced practitioners and diligent law school students will note possible challenges under the U.S. Constitution.[16] In any event, we do not think that waiting on, and hoping for, a legislative solution is the best approach. It may not come at all and, even if it does, it may not produce the desired result. Instead, we recommend that both borrowers and lenders take a proactive approach informed by the ISDA Fallback Protocol and the analysis herein.

CONCLUSION

In this Client Alert, we have shared an approach that we hope you will find helpful as your organization faces the challenges raised by the transition from LIBOR. During these chaotic and uncertain times, it is important to recognize that December 31, 2021 and the cessation of LIBOR as a representative interest rate index are right around the corner. Like past changes of similar scope, a coordinated and thoughtful approach is required to reach a good outcome for LIBOR transition. With the publication of the ISDA Fallback Protocol and the analysis contained herein, market participants will have the visibility into a workable solution that will align loan agreements and derivatives transactions, provide predictability and certainty, and mitigate legal, commercial and operational disruption, while minimizing basis risk and producing a fair result for both borrowers and lenders that minimizes unintended value transfers. At King & Spalding LLP, our LIBOR transition task force (consisting of attorneys across numerous practice areas) has long been engaged in detailed discussions with our borrower, bank and other financial institution clients about LIBOR-related issues, and we are working with them to develop solutions customized for their unique needs. Now is the time to decide on a plan of action and to begin implementing that plan in order to address the transition from LIBOR across affected agreements to an acceptable substitute interest rate index.

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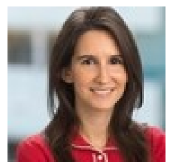

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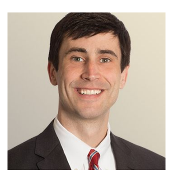

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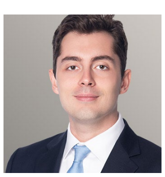

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Financial Services, Capital Markets and Commercial Contracts

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[1] King & Spalding LLP, "Client Alert: What Happened To My Interest Rate? Planning Now To Avoid Value Transfer And Other Risks Upon The Demise Of U.S. Libor" (October 22, 2020), available at: https://www.kslaw.com/news-and-insights/what-happened-to-my-interest-rate-planning-now-to-avoid-value-transfer-and-other-risks-upon-the-demise-of-us-libor.

[2] Bailey, Andrew "The Future of LIBOR", Bloomberg London (July 27, 2017), available at: https://www.fca.org.uk/news/speeches/the-future-of-libor.

[3] King & Spalding LLP, "Client Alert: Avoiding Windfalls on LIBOR Fallback Reference Rates" (December 17, 2019), available at: https://www.kslaw.com/news-and-insights/avoiding-windfalls-on-libor-fallback-reference-rates.

[4] Alternative Reference Rates Committee, "ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Floating Rate Notes" (April 25, 2019), available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/FRN_Fallback_Language.pdf.

[5] Alternative Reference Rates Committee, "ARRC Recommendations Regarding More Robust Fallback Language for New Originations of LIBOR Syndicated Loans" (June 30, 2020), available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/Updated-Final-Recommended-Language-June-30-2020.pdf.

[6] ARRC has published "guiding principles" for LIBOR fallback language in cash products (*ARRC Guiding Principles for More Robust LIBOR Fallback Contract Language in Cash Products* (July 9, 2018)), new originations and issuance of "Bilateral Business Loans" (*ARRC Recommendations Regarding More Robust Fallback Language for New Originations of LIBOR Bilateral Business Loans* (May 30, 2019)), "Floating Rate Notes" (*ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Floating rate Notes* (April 25, 2019)), "Securitizations" (*ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Securitizations* (May 31, 2019)), "Syndicated Loans" (*ARRC Recommendations Regarding More Robust Fallback Language for New Originations of LIBOR Syndicated Loans* (April 25, 2019)), and "Adjustable Rate Mortgages" *(ARRC Recommendations Regarding More Robust Fallback Language for New Closed-End Residential Adjustable Rate Mortgages* (November 15, 2019)). The foregoing publications contain recommendations for the appropriate trigger events that should result in the replacement of LIBOR and also provide timelines for each applicable financial product to implement steps to transition from LIBOR.

[7] *See* footnote 5.

[8] International Swaps and Derivatives Association, Inc., "ISDA 2020 IBOR FALLBACKS PROTOCOL" (October 23, 2020), available at: http://assets.isda.org/media/3062e7b4/08268161-pdf/. International Swaps and Derivatives Association, Inc., "Amendments to the 2006 ISDA Definitions to include new IBOR fallbacks" (October 23, 2020), available at: http://assets.isda.org/media/3062e7b4/23aa1658-pdf/. In addition, ISDA published frequently asked questions related to the ISDA Fallback Protocol, available at: http://assets.isda.org/media/3062e7b4/3cfa460a-pdf/.

[9] In the 2020 ARRC Recommendations, the ARRC included commentary suggesting that, for loans that are subject to interest rate hedges, borrowers may wish to amend applicable loan agreements to align with the ISDA Fallback Protocol in order to minimize basis risk. See Alternative Reference Rates Committee, "ARRC Recommendations Regarding More Robust Fallback Language for New Originations of LIBOR Syndicated Loans" (June 30, 2020), available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/Updated-Final-Recommended-Language-June-30-2020.pdf: "[B]ecause standard derivatives will not reference a forward-looking term rate, either as a fallback to USD LIBOR or in new SOFR-based derivatives, borrowers in the loan market who execute swaps may prefer to remove Term SOFR (and adjust all of the corresponding cross references within the fallback language) in order to fall back to Daily Compounded SOFR, to better align with ISDA's selected fallback rate. Note that other conforming changes may also be needed at the time a fallback is activated in order to maintain alignment with hedges".

[10] Ibid.

[11] More specifically, implementation of this approach involves simply deleting clause (a) from the definitions of "Benchmark Replacement" and "Benchmark Replacement Conforming Changes" that are set forth in the ARRC's "hardwired" approach in the 2020 ARRC Recommendations.

[12] LSTA has published its analysis, which shows that the Average 20-year simple/Compounded SOFR basis is 0% per annum for 1 month (0.02% per annum maximum) and 0.01% per annum for 3 months (0.05% per annum maximum). However, LSTA notes that Daily Compounded SOFR is more operationally complex than Daily Simple SOFR if a loan product has intra-period prepayments and trades without accrued interest. *See* LSTA "Operational Readiness in the Loan and CLO Market" (September 29, 2020), available at: https://www.lsta.org/content/operational-readiness-in-the-loan-and-clo-market/.

[13] The FCA has expressly stated that the timeline for the end of LIBOR publication has not changed due to COVID-19, though they have extended some target dates. *See* Financial Conduct Authority, "Impact of the coronavirus on firms' LIBOR transition plans" (March 25, 2020), available at: https://www.fca.org.uk/news/statements/impact-coronavirus-firms-libor-transition-plans. *See also* Financial Conduct Authority, "Further Statement from the RFRWG on the Impact of Coronavirus on the Timeline for Firms' LIBOR Transition Plans" (May 13, 2020), available at: https://www.fca.org.uk/news/statements/further-statement-rfrwg-impact-coronavirus-timeline-firms-libor-transition-plans.

[14] Alternative Reference Rates Committee, "Proposed Legislative Solution to Minimize Legal Uncertainty and Adverse Economic Impact Associate with LIBOR Transition" (March 6, 2020), available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Proposed-Legislative-Solution.pdf.

[15] Ibid.

[16] There have been concerns raised by some interested groups that the ARRC-proposed legislation would unconstitutionally impair existing financial contracts with LIBOR-linked rates by automatically altering such contracts to include transition language with SOFR as the index plus a spread adjustment to be selected by US regulators. Parties who feel harmed by such a mandatory, retroactive transition could conceivably bring suit under the Contract Clause of the United States Constitution, which prohibits impairment of contracts by state law unless the law a "legitimate public purpose" and the law is "appropriately tailored" (*Home Building & Loan Association v. Blaisdell*, 290 U.S. 398 (1934)). If the legislation is enacted into law and courts subsequently held that the proposed legislation does not pass the *Blaisdell* test, then some or all of the law would be invalidated, leaving contracts that did not otherwise adopt SOFR without a "fallback" reference rate for LIBOR.