

# Client Alert

## We've Come So Far, SOFR – Update

April 19, 2021

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On March 16, 2021, we released a [Client Alert](#) (our “[March 16 Client Alert](#)”)<sup>1</sup> that summarized key announcements made on March 5, 2021 regarding the transition away from the US dollar (“USD”) London Interbank Offered Rate (“LIBOR”) and highlighted their impact on the terms of certain transaction types. Since we released our March 16 Client Alert, there have been some key developments related to the transition away from USD LIBOR. We summarize these developments below.

### Key Developments Since March 16 Client Alert

#### ***The ARRC Releases Supplemental Recommendations of Hardwired Fallback Language for Syndicated and Bilateral Business Loans***

On March 25, 2021, the Alternative Reference Rates Committee (“ARRC”) released [supplemental recommendations](#)<sup>2</sup> of hardwired fallback language for USD LIBOR denominated syndicated and bilateral business loans. These recommendations supplement (and do not supersede) the ARRC’s [June 2020 recommendation for syndicated business loans](#)<sup>3</sup> and [August 2020 recommendation for bilateral business loans](#) (the “[ARRC 2020 Recommendations](#)”)<sup>4</sup> using the information provided in the March 5, 2021 [ICE Benchmark Administration](#) (“IBA”) and [Financial Conduct Authority](#) (“FCA”) announcements<sup>5</sup> “to simplify

<sup>1</sup> Our March 16 Client Alert is available online at: <https://www.milbank.com/en/news/weve-come-so-far-sofr.html>.

<sup>2</sup> ARRC, ARRC Supplemental Recommendations of Hardwired Fallback Language for LIBOR Syndicated and Bilateral Business Loans (March 25, 2021), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/arrc-supplemental-hardwired-recommendation> (the “[ARRC Supplemental Recommendations](#)”).

<sup>3</sup> ARRC, 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>.

<sup>4</sup> ARRC, ARRC Recommendations Regarding More Robust Fallback Language for New Originations of LIBOR Bilateral Business Loans (August 27, 2020), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/Updated-Final-Recommended-Bilateral-Business-Loans-Fallback-Language-August-27-2020.pdf>.

<sup>5</sup> See IBA, ICE LIBOR® Feedback Statement on Consultation on Potential Cessation (March 5, 2021), available at [https://www.theice.com/publicdocs/ICE\\_LIBOR\\_feedback\\_statement\\_on\\_consultation\\_on\\_potential\\_cessation.pdf](https://www.theice.com/publicdocs/ICE_LIBOR_feedback_statement_on_consultation_on_potential_cessation.pdf); FCA, Announcements on the end of LIBOR (March 5, 2021), available at <https://www.fca.org.uk/news/press-releases/announcements-end-libor>. For more information on the March 5, 2021 IBA and FCA announcements, please see our March 16 Client Alert.

the fallback language and to offer additional transparency into the spread adjustments that will be applied to fallback rates upon transition.”<sup>6</sup> Among other things, the ARRC Supplemental Recommendations:

- Make clear that a Benchmark Transition Event has already occurred with respect to USD LIBOR.
- Allow parties to specify the interest payment period (either monthly or quarterly) that will be used for business loans that have transitioned from USD LIBOR to a Daily Simple SOFR,<sup>7</sup> providing clarity regarding the spread adjustment that will be used for such loans.
- Hard code spread adjustment values in the definition of “Benchmark Replacement” now that the applicable spread adjustments were set on March 5, 2021 (as described in our March 16 Client Alert).
- Remove certain defined terms, such as “Benchmark Replacement Adjustment,” “Benchmark Replacement Date,” “Corresponding Tenor” and “Reference Time”, that are included in the ARRC 2020 Recommendations, and consolidate other defined terms included in the ARRC 2020 Recommendations.
- Revise the language relating to the pre-cessation trigger event in the definition of “Benchmark Transition Event” in the ARRC 2020 Recommendations to more closely align with the definition of “Index Cessation Event” in the International Swaps and Derivatives Association, Inc.’s (“ISDA”) [IBOR Fallbacks Supplement](#) (Supplement Number 70 to the 2006 ISDA Definitions) (the “[IBOR Supplement](#)”) and [ISDA 2020 IBOR Fallbacks Protocol](#) (the “[ISDA Protocol](#)”).<sup>8</sup> Specifically, the following language is used in the ARRC Supplemental Recommendations: “...all Available Tenors of such Benchmark are or will no longer be representative of the underlying market and economic reality that such Benchmark is intended to measure and that representativeness will not be restored.”<sup>9</sup>

### **ARRC Publishes Model for Using SOFR in New Issuances of Certain non-CLO Securitized Products**

On March 29, 2021, the ARRC published a [white paper](#) describing a model for using SOFR in non-collateralized loan obligation (“CLO”) asset-backed securities, mortgage-backed securities, and commercial mortgage-backed securities products (such products, collectively, “ABS”).<sup>10</sup> This model, which was designed and recommended by the ARRC’s Securitizations Working Group (the “ARRC SWG”), uses published 30-day Average SOFR, with a monthly reset, set in advance of the interest accrual period.<sup>11</sup> The ARRC SWG “believes that the use of 30-day Average SOFR aligns well with current market practices”.<sup>12</sup> The model is intended to be adaptable: the ARRC states in its white paper that “...[m]arket [p]articipants may select appropriate adjustments to the methodologies described herein in connection with any particular ABS issuance based on the unique attributes of the collateral backing the applicable securitization as well

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<sup>6</sup> ARRC Supplemental Recommendations at 3.

<sup>7</sup> “[Daily Simple SOFR](#)” is a backward-looking overnight rate based on the Secured Overnight Financing Rate (“[SOFR](#)”), averaged over the duration of the applicable tenor, with no compounding.

<sup>8</sup> See ISDA, [IBOR Fallbacks Supplement](#) (published on January 25, 2021), *available at* <http://assets.isda.org/media/3062e7b4/23aa1658-pdf/>; ISDA, [ISDA 2020 IBOR Fallbacks Protocol](#) (published on October 23, 2020), *available at* <http://assets.isda.org/media/3062e7b4/08268161-pdf/>.

<sup>9</sup> ARRC Supplemental Recommendations at 6 and 10-11.

<sup>10</sup> ARRC, [Options for Using SOFR in New ABS, MBS, and CMBS Products](#) (March 2021), *available at* <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/options-for-using-sofr-in-new-abs-mbs-cmbs-products-032921> (the “[ARRC Securitized Products Paper](#)”).

<sup>11</sup> The model uses the actual SOFR rates from the 30-day period before the applicable reset date, which members of the ARRC SWG determined to be preferable to alternatives for operational ease. See [ARRC Securitized Products Paper](#) at 1. The Federal Reserve Bank of New York publishes 30-day Average SOFR each business day at <https://apps.newyorkfed.org/markets/autorates/sofr-avg-ind>.

<sup>12</sup> [ARRC Securitized Products Paper](#) at 2.

as the desired terms of the related securities.”<sup>13</sup> However, we note that the white paper does not address corporate CLO products.

### ***New York State Governor Signs Legislation to Provide Legal Certainty with Respect to Issues Arising from Discontinuance of LIBOR***

On April 6, 2021, New York Governor Andrew Cuomo signed into law Senate Bill S297B, which is designed to “minimize costly and disruptive litigation by providing legal certainty for the issues arising under New York [law] resulting from the permanent discontinuance of LIBOR.”<sup>14</sup> The legislation, among other things, mandates the use of the recommended benchmark replacement (*i.e.*, a SOFR-based benchmark replacement, including a spread adjustment)<sup>15</sup> in any New York law-governed contract, security or instrument that (1) uses LIBOR as a benchmark and contains no fallback provisions or (2) contains fallback provisions that provide for a benchmark replacement that is based in any way on LIBOR.<sup>16</sup> In addition, the legislation provides a liability and litigation safe harbor to parties that have discretion under their contract to choose a replacement for LIBOR if they select the ARRC-recommended fallback for the product in question under such contract. However, note that the legislation does not affect any New York law-governed contract, security or instrument that (1) does not use LIBOR as a benchmark, that (2) does use LIBOR as a benchmark, but has fallback provisions that provide for a benchmark replacement that is not based on LIBOR (*e.g.* Prime Rate), or (3) where the parties to the contract have explicitly agreed that the legislation will not apply.

The legislation affects a tremendous number of New York law-governed “tough legacy” contracts, securities and instruments, and has been championed by key market participants. For example, it was welcomed by the ARRC, which presented the text upon which the legislation is based last year.<sup>17</sup> The Securities Industry and Financial Markets Association (“SIFMA”) also welcomed the legislation’s passage and encouraged Congress “to pass a federal law similar to the one passed in New York to address these issues on a national level.”<sup>18</sup>

### ***ARRC Encourages Market Participants to Transition without Reliance on Forward-Looking SOFR Term Rate***

On March 23, 2021, the ARRC announced that it will not be in a position to recommend a forward-looking SOFR term rate by mid-2021.<sup>19</sup> Additionally, the ARRC encouraged market participants not to wait for a forward-looking SOFR term rate for new contracts, but to instead continue to transition from LIBOR using

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<sup>13</sup> *Id.*

<sup>14</sup> See <https://www.nysenate.gov/legislation/bills/2021/S297>.

<sup>15</sup> “Recommended benchmark replacement” is defined in Senate Bill S297B as “a benchmark replacement, which shall include any recommended spread adjustment and any benchmark replacement conforming changes, that shall have been selected or recommended by a relevant recommending body.”

“Benchmark replacement” is defined in Senate Bill S297B as “a benchmark, or an interest rate or rates (which may or may not be based in whole or in part on a prior setting of LIBOR), to replace or substitute for LIBOR or any interest rate based on LIBOR following the occurrence of a LIBOR discontinuance event under or in respect of a contract, security or instrument.” See Section 12-101(f) and (g) of Senate Bill S297B, which is available at <https://www.nysenate.gov/legislation/bills/2021/S297>.

<sup>16</sup> See Section 12-102 of Senate Bill S297B, available at <https://www.nysenate.gov/legislation/bills/2021/S297>.

<sup>17</sup> See ARRC, ARRC Welcomes Passage of LIBOR Legislation by the New York State Legislature (March 24, 2021), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20210324-arrc-press-release-passage-of-libor-legislation>; ARRC, ARRC Endorses Decision to Sign New York State LIBOR Legislation into Law (April 7, 2021), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20210407-arrc-press-release-nys-legislation>.

<sup>18</sup> SIFMA, SIFMA Statement on Passage of New York State LIBOR Legislation (March 25, 2021), available at <https://www.sifma.org/resources/news/sifma-statement-on-passage-of-new-york-state-libor-legislation/>.

<sup>19</sup> ARRC, ARRC Provides Update on Forward-Looking SOFR Term Rate (March 23, 2021), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/arrc-press-release-term-rate-for-publication> (the “ARRC SOFR Term Rate Announcement”).

existing tools, such as [SOFR averages and index data](#) that can be applied in advance or in arrears (as described in the [User's Guide to SOFR](#)).<sup>20</sup>

ARRC's [Key Objectives for 2020](#) included the objective to “[e]stablish a request for proposals (“RFP”) process and criteria for recommendations in order to select an administrator of an ARRC-recommended forward-looking term SOFR rate to be published in the first half of 2021 if liquidity in SOFR derivatives markets has developed sufficiently, and also establish recommended scopes of use for such a term rate.”<sup>21</sup> Although the ARRC established the RFP process<sup>22</sup> and is currently reviewing submissions from potential administrators, the ARRC (i) believes it is not yet in a position to recommend a SOFR term rate with confidence based on the current level of liquidity in SOFR derivatives markets and (ii) is still evaluating the limited set of cases in which it believes a term rate could be used.<sup>23</sup> Additionally, the ARRC cannot guarantee that it will be in a position to recommend an administrator that can produce a robust forward-looking SOFR term rate by the end of 2021.<sup>24</sup>

### ***ARRC Publishes White Paper Describing Suggested Fallback Formula for USD LIBOR ICE Swap Rate***

On March 24, 2021, the ARRC published a [white paper](#) describing its suggested formula for calculating a fallback from the USD LIBOR ICE Swap Rate to a spread-adjusted SOFR Swap Rate.<sup>25</sup> The ARRC's suggested formula, which was developed by the ARRC Market Structure and Paced Transition Working Group, was created in light of the reality that (i) there will likely be no available cleared USD LIBOR swap data that can be used to compute and publish the 1100 USD LIBOR ICE Swap Rate (the “LIBOR ISR”) after June 30, 2023; (ii) nearly all existing contractual LIBOR ISR fallbacks rely on conducting a dealer poll and/or in relying on calculation agent determination (neither of which would be practical or desirable in the context of a cessation of the LIBOR ISR); and (iii) contracts that are linked to USD LIBOR in an indirect manner through reference to USD ICE Swap Rate are not covered by the IBOR Supplement or the ARRC-recommended fallback language.<sup>26</sup>

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<sup>20</sup> See ARRC SOFR Term Rate Announcement.

<sup>21</sup> ARRC, 2020 Objectives (April 2020), available at [https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC\\_2020\\_Objectives.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_2020_Objectives.pdf).

<sup>22</sup> ARRC, RFP for Vendor to Publish Forward-Looking SOFR Term Rates (September 2020), available at [https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/SOFR\\_Term\\_Rates\\_RFP.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/SOFR_Term_Rates_RFP.pdf).

<sup>23</sup> ARRC SOFR Term Rate Announcement.

<sup>24</sup> ARRC SOFR Term Rate Announcement.

<sup>25</sup> ARRC, Suggested Fallback Formula for the USD LIBOR ICE Swap Rate (March 2021), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/arrc-white-paper-on-suggested-fallback-formula-for-the-usd-libor-ice-swap-rate> (the “ARRC LIBOR ISR Paper”).

<sup>26</sup> ARRC LIBOR ISR Paper at 1-3.

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