

REVERSEinquiries

ARRC Releases its Proposed NYS Legislative Solution for Existing USD LIBOR Contracts

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Included in the board minutes of the November 2019 Alternative Reference Rates Committee (“ARRC”) were summary slides of a proposed legislative solution for USD LIBOR contracts governed by New York law.¹ On March 6, 2020, the ARRC published the complete “Proposed Legislative Solution to Minimize Legal Uncertainty and Adverse Economic Impact Associated with LIBOR Transition” (the “NYS Proposal”).² The NYS Proposal governs financial contracts referencing USD LIBOR, including loans, securitizations, and floating rate notes (“FRNs”). This article focuses on the effect of the NYS Proposal on floating rate notes.

Outstanding USD LIBOR FRNs issued prior to the use of any fallback provision to another reference rate (such as the secured overnight financing rate, or “SOFR”) (“Legacy FRNs”) will, without any intervention, become fixed rate notes. That is because the fallback provisions in Legacy FRNs, which follow the 2006 ISDA Definitions and involve polling banks for quotes on rates, did not contemplate a permanent LIBOR cessation. Consequently, most of these outstanding Legacy FRNs will keep resetting at the last published USD LIBOR rate, effectively converting into fixed rate notes at that last published USD LIBOR rate. Under the terms of the Legacy FRNs, the consent of 100% of the holders would be required to amend the interest rate provisions.

The NYS Proposal, if adopted, would automatically replace USD LIBOR in a typical Legacy FRN with SOFR (which is the “Recommended Benchmark Replacement”).³ Under Sections 100(1) and (2) of the NYS Proposal, on the LIBOR Replacement Date, the fallback provisions in the Legacy FRNs would automatically trigger a replacement of USD LIBOR with SOFR, and the polling provisions in the Legacy FRN would be disregarded. Under Section 100(4)(d) of the NYS Proposal, the application to any Recommended Benchmark Replacement of any cap, floor, modifier or spread adjustment to which USD LIBOR had been subject under the terms of the Legacy FRN would not be altered or impaired.⁴

¹ The ARRC’s November 2019 board minutes are available at: <https://nyfed.org/2vL2Frc>.

² The NYS Proposal is available at: <https://nyfed.org/2UHn1KG>.

³ 3 The NYS Proposal defines certain terms in the same way as the ARRC’s “Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Floating Rate Notes” (the “ARRC Fallback Recommendations”), such as “LIBOR Discontinuance Event,” “LIBOR Replacement Date” and “Relevant Recommending Body.” A Recommended Benchmark Replacement includes any Recommended Spread Adjustment and any Benchmark Replacement Conforming Changes, which have been selected or recommended by a Relevant Recommending Body (which is defined to include the ARRC). “Benchmark Replacement Conforming Changes” closely matches the definition in the ARRC Fallback Recommendations.

⁴ Most likely, any modifier or spread adjustment that had been applicable to the Legacy FRN would be adjusted under the Benchmark Replacement Conforming Changes, without liability to the entity making the determination.

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The NYS Proposal also contains a number of provisions designed to rebut a claim of breach of contract by Legacy FRN holders:

- Section 200(2) provides that the application of the statute, by using a Recommended Benchmark Replacement as a Benchmark Replacement or implementing Benchmark Replacement Conforming Changes, will not constitute a breach of a contract or of the security.
- Section 200(3) protects the entity or person that determines which changes shall be made to a Legacy FRN, such as a calculation agent, issuer or trustee, from liability from damages or any action in law or equity.
- In a nod to the requirements under a typical indenture for 100% consent of the holders of any debt security (including Legacy FRNs) to any modification of or amendment to the indenture that would have a material or adverse effect on the holders, Section 200(4) provides that the use of a Recommended Benchmark Replacement or the implementation or performance of Benchmark Replacement Conforming Changes as provided in the NYS Proposal shall not be deemed to be an amendment or modification of the Legacy FRNs and shall not impair or have an adverse effect on any person's rights or obligations.

An open question is whether the NYS Proposal, if adopted, would clash with Section 316(b) of the Trust Indenture Act of 1939 (the "TIA"), which reads, in part:

"Prohibition of impairment of holder's right to payment. Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder...."

Theoretically, a Legacy FRN holder could make the case that the NYS Proposal is void in that it impairs the holder's right to interest without the holder's consent, as required under Section 316(b) of the TIA. This type of litigation would most likely arise if the last USD LIBOR fixing is higher than the rate provided by the Recommended Benchmark Replacement.⁵

As of this writing, there has been no public response by the NYS Legislature to the NYS Proposal. One could assume that the NYS Legislature currently has its hands full with other pressing concerns.

⁵ For a more detailed discussion of the TIA aspect, see the article available at: <https://bit.ly/2vSwark>.