

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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**Date:** December 2, 2022  
**To:** Board of Governors  
**From:** Staff<sup>1</sup>  
**Subject:** Final Regulation Implementing the Adjustable Interest Rate (LIBOR) Act

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**Action Requested:** Staff requests approval to (i) publish the attached draft *Federal Register* notice and final rule, which would implement the Adjustable Interest Rate (LIBOR) Act; and (ii) make technical, non-substantive changes to the notice and final rule prior to publication.

**Executive Summary:**

- The U.K.'s Financial Conduct Authority (FCA), which regulates LIBOR's administrator, has announced that U.S. dollar (USD) LIBOR, formerly known as the London Interbank Offered Rate, will cease after June 30, 2023.
- On March 15, 2022, Congress enacted the Adjustable Interest Rate (LIBOR) Act (the "Act") to address references to LIBOR in contracts that (i) are governed by U.S. law; (ii) will not mature before June 30, 2023; and (iii) lack fallback provisions providing for a clearly defined and practicable replacement for LIBOR. In July 2022, the Board invited public comment on a notice of proposed rulemaking (proposed rule) to implement the Act.<sup>2</sup>
- Consistent with the Act, the final rule replaces references to LIBOR in such contracts with one of five Board-selected benchmark replacements based on the Secured Overnight Financing Rate (SOFR). Each Board-selected benchmark replacement incorporates spread adjustments specified in the Act. The final rule is substantially similar to the proposal. In response to comments, however, the final rule mirrors certain continuity-of-contract and safe harbor provisions of the Act and provides certain clarifications, including to the definition of a "determining person" who contractually can select a replacement for LIBOR and the treatment of references to Eurodollar rates.

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<sup>2</sup> The comment period ended on August 29, 2022.

## **Background on LIBOR and the Adjustable Interest Rate (LIBOR) Act:**

LIBOR is an interest rate benchmark that was the dominant reference rate used in financial contracts in recent decades.<sup>3</sup> LIBOR is intended to reflect the rate at which large banks can borrow wholesale funds on an unsecured basis and is calculated based on submissions contributed by a panel of large, globally active banks. On March 5, 2021, the FCA, which regulates LIBOR's administrator, announced that after December 31, 2021, LIBOR would cease to be published in 24 currency and tenor pairs, including one-week and two-month USD LIBOR. To allow most legacy USD LIBOR contracts to mature without disruption, the FCA announced that the remaining tenors of USD LIBOR would continue through, but cease to be published in their current panel-based form after, June 30, 2023.<sup>4</sup> Notwithstanding governmental and private-sector efforts to encourage market participants to prepare for the cessation of USD LIBOR, a significant number of existing contracts that reference USD LIBOR (i) will not mature by June 30, 2023; (ii) lack adequate fallback provisions providing for a clearly defined and practicable replacement benchmark; and (iii) cannot be easily amended. Recognizing the need for a uniform, nationwide solution for replacing references to LIBOR in these contracts, Congress enacted the Act to, among other things, avoid disruptive litigation related to these contracts.<sup>5</sup>

In general, the Act distinguishes among three categories of contracts that reference LIBOR (LIBOR contracts).<sup>6</sup> First, LIBOR contracts that identify a workable benchmark replacement—meaning a benchmark replacement that is not based in any way on LIBOR or on a benchmark involving a poll or survey similar to LIBOR—generally will transition according to

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<sup>3</sup> For example, as of the end of 2020, the outstanding gross notional value of all financial products referencing USD LIBOR was estimated to be \$223 trillion. See Alternative Reference Rate Committee (ARRC), *Progress Report: The Transition From U.S. Dollar LIBOR* (Mar. 2021) at 3, <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/USD-LIBOR-transition-progress-report-mar-21.pdf>. While over-the-counter and exchange-traded derivatives account for the vast majority of this estimated exposure, USD LIBOR also is referenced in trillions of dollars' worth of business and consumer loans, bonds, securitizations, and nonfinancial corporate contracts.

<sup>4</sup> See FCA, *FCA Announcement on Future Cessation and Loss of Representativeness of the LIBOR Benchmarks* (Mar. 5, 2021), <https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>. The FCA has announced it may require LIBOR's administrator to continue publishing one-, three-, or six-month USD LIBOR on a synthetic basis until September 30, 2024. If published, synthetic LIBOR would no longer be representative of the underlying market that these settings of USD LIBOR are intended to measure.

<sup>5</sup> See 12 U.S.C. § 5801 *et seq.*

<sup>6</sup> The Act defines "LIBOR contract" broadly to include any obligation or asset that, by its terms, uses the overnight, one-month, three-month, six-month, or 12-month tenors of USD LIBOR as a benchmark. See 12 U.S.C. § 5802(16).

their terms to the contractually-agreed-upon benchmark replacement.<sup>7</sup> Second, under the Act, LIBOR contracts that either (i) contain no fallback provisions; or (ii) contain fallback provisions identifying a benchmark replacement that is not workable will transition to a Board-selected benchmark replacement after June 30, 2023.<sup>8</sup> The Act specifies that any Board-selected benchmark replacement must be based on SOFR—a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities that is published daily by the Federal Reserve Bank of New York (FRBNY)—and incorporate tenor spread adjustments specified in the Act.<sup>9</sup> Third, some LIBOR contracts contain fallback provisions that authorize a “determining person” to select a benchmark replacement. Where a determining person selects a workable benchmark replacement on a timely basis, the LIBOR contract generally will transition to that benchmark replacement as provided in the LIBOR contract.<sup>10</sup> Where a determining person has not selected a workable benchmark replacement by at least June 30, 2023, the Act states that such LIBOR contracts will transition to the Board-selected benchmark replacement.<sup>11</sup>

### **Background on the Proposed Rule:**

The proposed rule largely would have codified into regulation the statutory provisions described above. Specifically, under the proposed rule, contracts that either contain no fallback provisions or fallback provisions that are not workable would have transitioned to the applicable Board-selected benchmark replacement after June 30, 2023.<sup>12</sup>

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<sup>7</sup> See 12 U.S.C. § 5803(f)(2).

<sup>8</sup> See 12 U.S.C. § 5803(a)–(b). For LIBOR contracts that transition in this way to the Board-selected benchmark replacement, the Act provides a series of statutory protections for persons who use the Board-selected benchmark replacement, including certain legal immunities from claims arising out of its use. See 12 U.S.C. § 5804.

<sup>9</sup> See 12 U.S.C. § 5802(6). See also FRBNY, *Secured Overnight Financing Rate Data*, <https://www.newyorkfed.org/markets/reference-rates/sofr> (last visited Nov. 29, 2022).

<sup>10</sup> See 12 U.S.C. § 5803(c)(1)–(2), (f)(3). A determining person must select the benchmark replacement by the earlier of (i) the London business day after June 30, 2023, or (ii) the latest date for selecting a benchmark replacement according to the terms of the LIBOR contract. *Id.* Although the Act does not require a determining person to select the Board-selected benchmark replacement as the benchmark replacement for a LIBOR contract, the Act provides a series of statutory protections for any determining person who does so. See 12 U.S.C. § 5804.

<sup>11</sup> See 12 U.S.C. § 5803(c)(3). The Act also contemplates that where a LIBOR contract transitions to the Board-selected benchmark replacement (either by operation of law or through the selection of a determining person), certain conforming changes to the contract may be necessary to facilitate this transition. See 12 U.S.C. § 5802(4). The Board is authorized to determine such “benchmark replacement conforming changes” for any category of LIBOR contract. In addition, certain private parties (calculating persons) may determine such benchmark replacement conforming changes for certain categories of LIBOR contracts. *Id.* The Act provides a series of statutory protections for calculating persons in this scenario. See 12 U.S.C. § 5804.

<sup>12</sup> See § 253.3(a)(1) of the proposed rule.

The proposed rule would have identified Board-selected benchmark replacements for three categories of LIBOR contracts: derivative transactions, certain contracts involving government-sponsored enterprises (GSEs),<sup>13</sup> and all other contracts subject to the Act. It also would have reserved authority for the Board to determine benchmark replacement conforming changes for LIBOR contracts that transition to the Board-selected benchmark replacement.<sup>14</sup>

### **Overview of the Final Rule:**

The Board received many comments expressing support for the proposed rule. Only one commenter opposed the proposed rule based on a disagreement with the policy objectives of the Act. Some commenters indicated that the proposed rule's definition of LIBOR contracts subject to the rule could differ from the scope of the Act. In response, the final rule hews closely to the statutory text in describing those LIBOR contracts to which the rule applies. Commenters also requested that the final rule define "determining person" to include a person with a contingent future right to select a replacement for LIBOR (i.e., in specific circumstances), thereby clarifying that such a person can select the Board-selected benchmark replacement in advance with all of the Act's statutory protections for that selection.<sup>15</sup> As this interpretation is consistent with Congressional intent and would promote a smooth transition, the final rule defines "determining person" as requested. In addition, some commenters suggested that the final rule clarify the treatment of contracts that would transition to poll-based Eurodollar rates if LIBOR is unavailable. The final rule clarifies that any fallback provision requiring an inquiry for Eurodollar rates would be disregarded, consistent with the Act.

Many commenters supported the proposed rule's Board-selected benchmark replacements. Some commenters, however, requested that the Board clarify that only GSEs regulated by the Federal Housing Finance Agency (FHFA), rather than all GSEs, would be treated as a separate category, since the proposed Board-selected benchmark replacement for those contracts was intended to match transition efforts by those GSEs. Another commenter requested that Federal Home Loan Bank advances have a separate benchmark replacement to

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<sup>13</sup> Contracts involving government-sponsored enterprises would have included certain mortgage loans and related instruments for which a government-sponsored enterprise (e.g., Fannie Mae and Freddie Mac) is a party. *See* § 253.2 of the proposed rule (defining "government-sponsored enterprise (GSE)" and "covered GSE contract").

<sup>14</sup> *See* § 253.5(a)(1) of the proposed rule; *see also supra* n.10. It also would have mirrored statutory language preempting state or local law relating to selection of a benchmark replacement. *See* § 253.6 of the proposed rule.

<sup>15</sup> Commenters indicated this interpretation also would clarify the person's ability to make that selection in the event synthetic LIBOR is published.

match existing transition efforts. Commenters also requested that asset-backed securitizations (ABS) composed predominantly of Federal Family Education Loan Program (FFELP) loans transition to a separate SOFR rate that matches the statutory benchmark replacement for FFELP loans.<sup>16</sup> Having considered these comments, the final rule identifies the following Board-selected benchmark replacements:

- For a LIBOR contract that is a *derivative transaction*, the “Fallback Rate (SOFR)” as defined in the 2020 IBOR Fallbacks Protocol published by the International Swaps and Derivatives Association (ISDA protocol), which incorporates the statutorily prescribed tenor spread adjustment.<sup>17</sup>
- For a LIBOR contract that is an *FHFA-regulated-entity contract*:
  - For *Federal Home Loan Bank advances*, the “Fallback Rate (SOFR)” as defined in the ISDA protocol; and
  - For *all other FHFA-regulated-entity contracts*, SOFR (in place of overnight LIBOR) or 30-day compounded average SOFR published by FRBNY (“30-day Average SOFR,” in place of one-, three-, six-, or 12-month LIBOR), plus the applicable statutorily prescribed tenor spread adjustment.<sup>18</sup>
- For a LIBOR contract that is a *FFELP ABS*, either (i) 30-day Average SOFR (for one-, six-, and 12-month LIBOR) or (ii) 90-day compounded average SOFR published by FRBNY (for three-month LIBOR), plus the applicable statutorily prescribed tenor spread adjustment.<sup>19</sup>
- For *all other LIBOR contracts*, including consumer loans, SOFR (in place of overnight LIBOR) or term SOFR published by CME Group Benchmark Administration, Ltd. (in place of one-, three-, six-, or 12-month LIBOR), plus the statutorily prescribed tenor spread adjustment.<sup>20</sup>

In response to comments, the final rule also identifies certain benchmark replacement conforming changes and codifies into regulation certain continuity-of-contract and safe harbor provisions of the Act.

## Attachments

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<sup>16</sup> Commenters also suggested additional contract categories with different Board-selected benchmark replacements. However, as the LIBOR Act would replace LIBOR with a Board-selected benchmark replacement by operation of law, the final rule aims to create a simple, clear, and manageable taxonomy with as few categories as possible.

<sup>17</sup> See § 253.4(a) of the final rule. The ISDA protocol allows parties to derivative transactions and other financial contracts to incorporate more robust fallback provisions into their agreements to replace LIBOR references with SOFR-based benchmark replacements. In general, any LIBOR contract that is eligible to use the ISDA protocol would be considered a derivative transaction. See § 253.2 of the final rule.

<sup>18</sup> See § 253.4(b)(3) of the final rule.

<sup>19</sup> See § 253.4(b)(4) of the final rule.

<sup>20</sup> See § 253.4(b)(1)–(2) of the final rule. The final rule also incorporates the statutorily prescribed one-year transition tenor spread adjustment for consumer loans. To simplify the calculation of the benchmark replacement during the transition period, the final rule states that a particular rate published by Refinitiv Limited is deemed equivalent to the Board-selected benchmark replacement for consumer loans. See *id.*