FRB Proposes LIBOR Regulation

August 30, 2022

On July 28, 2022, the Board of Governors of the Federal Reserve System (the "FRB") published a proposed regulation to implement the Adjustable Interest Rate (LIBOR) Act ("Act"). Due to problems with London Interbank Offer Rate (LIBOR) no longer being representative of the underlying borrowing costs of banks that LIBOR was intended to reflect, LIBOR is scheduled to be discontinued on June 30, 2023. While the federal banking regulators previously required that lenders stop writing new contracts using LIBOR as of December 31, 2021, there are a significant number of existing contracts that reference USD LIBOR that will not mature by June 30, 2023, and cannot be easily amended. Of particular concern are so-called "tough legacy contracts." Tough legacy contracts not only reference LIBOR and will not mature by June 30, 2023, but also lack adequate fallback provisions providing for a clearly defined or practicable replacement benchmark following the cessation of LIBOR.

To provide a uniform solution to this problem, on March 15, 2022, Congress enacted the Act as part of the Consolidated Appropriations Act of 2022. Among other things, the Act lays out a set of default rules that apply to tough legacy contracts subject to U.S. law.

The Act authorizes the FRB to promulgate regulations to facilitate the implementation of the Act. While the recently proposed Regulation ZZ closely follows the text of the Act, it also provides additional guidance and clarification of some technical issues. Additionally, in the Section-by-Section Analysis in the proposed rule, the FRB noted that the Act may potentially not apply to a subset of tough legacy contracts, specifically those that contain fallback provisions that either identify a clear and practicable benchmark replacement or authorize a determining person to select a benchmark replacement, but that are triggered only when LIBOR is unavailable. The FRB is concerned that the fallback provisions in these contracts are not triggered when LIBOR is available but non-representative. The FRB has asked for public comment on whether its approach in the proposed regulation to provide a solution to those contracts is workable under the Act. The underlying concern of the FRB is the possibility that a "synthetic LIBOR" may be published after June 30, 2023, which could give lenders the impression that "LIBOR" is still available for use as the index for those contracts. It is likely that this issue will be resolved in the final rule.

Comments on proposed Regulation ZZ were due by August 29, 2022, and the Act requires the FRB to publish its final rule by September 11, 2022, so answers to the remaining questions around LIBOR phaseout will be available soon.

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