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Certainty and Simplification: Updates on LIBOR's Cessation

On March 5, 2021, the United Kingdom's financial market regulator, the [Financial Conduct Authority](#) (FCA), and the [Intercontinental Exchange Benchmark Administration](#) (IBA), the authorized regulator of the London Inter-bank Offered Rate (LIBOR), each made announcements regarding the future of LIBOR. Both announcements provided much-needed certainty for financial markets and market participants as to both the timing of the LIBOR termination and the economic impact of the transition to alternative reference rates.

Cessation Certainty

The announcements confirmed that IBA could no longer publish LIBOR and therefore set specific cessation dates for all LIBOR tenors. Specifically, all non-U.S. LIBOR tenors shall cease on December 31, 2021, and with respect to U.S. LIBOR, the cessation dates shall be as follows:

- December 31, 2021 for 1 Week and 2 Month tenors; and
- June 30, 2023 for Overnight and 1,3,6, and 12 Month tenors.

The one caveat to these firm cessation dates is that, under the UK's Financial Services Bill, FCA possesses the ability to require IBA to continue publishing 1-Month, 3-Month and 6-Month U.S. LIBOR after June 30, 2023, provided that IBA does so on a "synthetic" basis, meaning it must change its methodology for the rates. However, FCA has not stated whether it will exercise this requirement, but it has indicated that it will consult and evaluate whether the new "synthetic" U.S. LIBOR might be necessary for certain "tough legacy" financial contracts, where implementing a new replacement reference rate would be particularly problematic.

In addition to the timing certainty, the recent announcements provided additional clarity on the economic impact of transition away from LIBOR. The economic clarity stems from a statement by the International Swaps and Derivatives Association (ISDA) that pursuant to ISDA IBOR Fallbacks Protocol and ISDA IBOR Fallbacks

Supplement, an “Index Cessation Event” occurs upon the earlier of LIBOR (i) no longer being provided or (ii) becoming “non-representative.” According to ISDA, per FCA’s announcement that LIBOR will cease to be published after the dates set forth above or will be “non-representative,” an “Index Cessation Event” did occur. Further, with an “Index Cessation Event” having occurred, the fallback spread adjustment is also established. Referencing the FCA announcement, [ISDA](#) declared, “Today’s announcement constitutes an index cessation event under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings. As a result, the fallback spread adjustment published by Bloomberg is fixed as of the date of the announcement for all euro, sterling, Swiss franc, U.S. dollar and yen LIBOR settings.” As a result, market participants no longer face the uncertainty of when an index cessation event will occur or what the spread adjustments might be.

Simplifying Fallback Language

Following the certainty provided by FCA and IBA announcements, on March 25, 2021, the Alternative Reference Rates Committee (ARRC) supplemented its [recommended fallback language](#) for new originations of U.S. LIBOR denominated syndicated and bilateral business loans. The supplemental fallback language simplifies the fallback language recommended by ARRC on June 30, 2020, for syndicated loans and on August 27, 2020, for bilateral business loans while maintaining ARRC’s stated goal that lenders and borrowers implement the Secured Overnight Financing Rate (SOFR) “hardwired” fallback language for clarity and certainty as market participants prepare for LIBOR’s upcoming cessation. However, while ARRC continues to [strongly recommend its “hardwired” fallback language](#), ARRC reiterated that whether lenders and borrowers do so is voluntary, and that lenders and borrowers should independently evaluate their existing financial contracts and decide whether to implement such recommended language.

By leaning on the economic and timing certainty provided by the FCA and IBA announcements, ARRC was able to update its previously recommended fallback language to “simplify the fallback

language and to offer additional transparency into the spread adjustments that will be applied to fallback rates upon transition.” More specifically and most notably, ARRC’s updated language: (i) eliminates and consolidates definitions now that there are set dates for when the trigger event for the transition away from LIBOR will occur, (ii) provides for what the payment period will be for loans that have made the transition to Daily SOFR, and (iii) with the spread adjustments having been fixed, ARRC implements the spread adjustment values within the definition of “Benchmark Replacement.”

Alternatives to the Alternative

While ARRC continues to promote, and many large traditional banks are adopting, SOFR as the preferred alternative reference rate to LIBOR, other alternative reference rates are also becoming more popular in the market. One alternative rate, the American Interbank Offered Rate, more commonly known as “Ameribor,” has also been recently introduced to the markets. Ameribor is published on the American Financial Exchange (AFX) and is calculated on the weighted average of unsecured overnight interbank transactions on the AFX. Community, state and smaller regional banks may prefer Ameribor as an alternative replacement rate under the theory that Ameribor accounts for credit risk in the markets and the AFX is a regulated exchange.

Additionally, *The Wall Street Journal* reported on May 13, 2021, that Bank of America Corp. and JPMorgan Chase & Co. entered into a derivatives transaction using the Bloomberg Short Term Bank Yield Index (BSBY), which is published by Bloomberg on a daily basis. Bloomberg first announced BSBY in January 2021 with the intent of creating an alternative to SOFR that provides the market a credit-sensitive index measuring the average yields at which large global banks access U.S. dollar senior unsecured margin wholesale funding.

Takeaways

With the recent FCA and IBA announcements, finance market participants now have certainty as to when the termination of the different LIBOR tenors will occur and also what that cessation event

means for fallback spread adjustments. As a result, ARRC was able to simplify its recommended fallback language while maintaining the substance of its recommendations – that both lenders and borrowers need to evaluate their existing loan documents and implement a “hardwired approach” adopting SOFR as the replacement reference rate.

While ARRC continues to push the “hardwired approach” and hopes the updated and simplified fallback language will provide clearer guidance for lenders and borrowers, adopting SOFR and the hardwired approach remains a voluntary and independent decision for market participants, who now also have alternatives to SOFR, such as Ameribor and BSBY, which both aim to provide a more credit-sensitive reference rate that could be better suited for certain lenders and borrowers.

Have questions or need assistance with the post-LIBOR transition? Contact [Austin Connor](#) or [Becky Moore](#) of Frost Brown Todd’s [Financial Services](#) industry team.

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