

## Latest Milestone in LIBOR Replacement Passed

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This past Monday, July 26, marked passage of the most recent major milestone in the replacement of LIBOR as the benchmark USD interest rate. Following the recommendation of the CFTC's Market Risk Advisory Committee (MRAC) Interest Rate Benchmark Reform Subcommittee, on July 26, 2021 interdealer brokers replaced trading in LIBOR linear swaps with SOFR linear swaps. This switch is a precursor to the recommendation of SOFR term rates. The switch does not apply to trades between dealers and their non-dealer customers.

The July 26 switch, part of phase one of MRAC's "SOFR First" market best practices, is the latest in a series of fast-paced developments to replace LIBOR that have been seen so far in 2021. In this post, we summarize several of the key developments in the transition to SOFR and other alternative risk-free rates.

### ***LIBOR Cessation Timeline***

On March 5, 2021, ICE Benchmark Administration ("IBA"), the administrator for LIBOR, and its regulator, the UK based Financial Conduct Authority ("FCA"), issued statements confirming that LIBOR will either cease to be published or will no longer be deemed representative after the following dates:

- December 31, 2021 for all non-U.S. LIBOR settings (e.g., EUR, GBP, CHF, JPY) and for the lesser-used USD LIBOR settings (e., 1 week and 2 months); and
- June 30, 2023 for remaining USD LIBOR settings (overnight and 1-, 3-, 6- and 12-month).

The statements constitute a trigger event for purposes of the "fallback" provisions under various industry documentation, including ISDA's Fallbacks Supplement and Protocol for derivatives (as an "Index Cessation Event") and the Alternative Reference Rates Committee's ("ARRC's") hardwired fallback language for certain cash products (as a "Benchmark Transition Event").

The statements thus serve to fix the spread adjustment for SOFR and other replacement risk-free

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rates.[1] However, while the spread is fixed as of March 5, 2021, the relevant fallback rates (including the spread) will begin applying on the date the relevant LIBOR setting ceases to be published or is deemed no longer representative (e.g., June 30, 2023 for the most significant USD LIBOR rates).

## ***ISDA IBOR Fallbacks Supplement and Protocol***

On January 25, 2021, the ISDA IBOR Fallbacks Supplement and related Protocol became effective.

The IBOR Fallbacks Supplement updates the 2006 ISDA Definitions by amending existing “Floating Rate Option” definitions referencing certain IBORs (interbank offered rates such as LIBOR) to incorporate certain “hardwired” fallbacks to “risk-free rates” that become operational upon the cessation of the specified IBOR. These fallbacks apply to swaps entered on and after January 25, 2021 that incorporate the 2006 ISDA Definitions.

For parties that wish these fallbacks to apply to swaps entered prior to January 25, 2021 or to swaps that do not incorporate the 2006 ISDA Definitions, the IBOR Fallbacks Protocol provides a mechanism for parties to amend all (but not less than all) of their “legacy” IBOR contracts simultaneously with all other protocol adherents. For those that do not wish to adhere to the Protocol, ISDA has published a set of “bilateral” templates which allow parties to incorporate the Protocol’s amendments into their trading documentation.

## ***New York Legislation***

On April 6, 2021, New York Governor Cuomo signed into law new legislation intended to facilitate the transition from LIBOR of any contract, security or instrument that (i) is governed by New York law, (ii) uses USD LIBOR in making any calculation or determination, and (iii) either does not include a LIBOR fallback provision or contains fallback provisions that would result in a LIBOR-based rate.

The legislation seeks to encourage broad adoption of SOFR, as well as to minimize legal uncertainty and litigation risk, by addressing the consequences of USD LIBOR cessation for these “tough legacy” contracts.

The legislation amends the New York General Obligations Law, with immediate effect, to replace USD LIBOR in these contracts, “by operation of law,” with the SOFR-based benchmark replacement, with such replacement occurring on the date that USD LIBOR permanently ceases to be published or the date of any public announcement by the relevant recommending body that USD LIBOR is no longer representative.

Congress is considering similar legislation that would apply at the Federal level.

## ***SOFR First***

On July 13, 2021, MRAC adopted the “SOFR First” initiative. The initiative recommends a phased transition from USD LIBOR to SOFR in the interdealer market. Specifically, implementation of SOFR First would take place in four phases:

1. USD Linear Swaps: As mentioned above, with effect on July 26, 2021, interdealer brokers have replaced new trading of USD LIBOR linear swaps with trading of SOFR linear swaps.

2. Cross-Currency Swaps: On and after September 21, 2021, interdealer brokers would replace trading of LIBOR cross-currency swaps with SOFR cross-currency swaps.
3. Non-Linear Derivatives: Transition date to be determined.
4. Exchange-Traded Derivatives: Transition date to be determined.

The SOFR First initiative is expected to facilitate efforts to phase out LIBOR and increase liquidity in SOFR-based trading and to result in formal recommendation of a “term SOFR” rate to replace LIBOR for certain cash products.

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## FOOTNOTES

[1] The fixed spread adjustments for 1-month, 3-month, 6-month and 12-month USD LIBOR are 0.11448%, 0.26161%, 0.42826% and 0.71513%, respectively.

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