Preparing for LIBOR Replacement—A Project Plan Discussion and Legal Analysis

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Agenda

- **A short background**
- **The current status**
- **A project plan approach**
  - **Risk Analysis**
  - **Asset categorization to identify and quantify risk**
- **LIBOR substitution risks for bank functions**
  - **Lending**
    - **Commercial**
    - **Consumer**
  - **Corporate Trust functions**
  - **Investment advisory**
- **Litigation strategy and planning**

A Short Background

- LIBOR stands for the London Interbank Offered Rate
  - It is a global floating benchmark interest rate
  - LIBOR is calculated daily in 5 currencies:
    - USD
    - EUR
    - GBP
    - JPY
    - CHF
- Approximately $200 trillion in outstanding transactions using the reference rate of USD LIBOR
  - 95% consist of derivatives
- LIBOR is determined each day based on the representations of panel banks as to the rates at which they could each borrow on the London interbank lending market
- USD LIBOR is calculated from an average of 18 bank submissions with the 4 highest and lowest submissions excluded

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A Short Background

- Reduction in actual LIBOR-based unsecured borrowings by large banks has created a significant reliability gap
  - https://www.fca.org.uk/news/speeches/the-future-of-libor
  - Expert judgments rather than actual transactions now being relied upon
- In 2014 numerous international regulators and stakeholder groups begin work on establishing alternative reference rates
  - Federal Reserve Board created the "Alternate Reference Rates Committee" or "ARRC" to identify alternative, transaction based reference rate to replace LIBOR
  - In June of 2017 the ARRC identified the "*Secured Overnight Financing Rate*" ("SOFR") as its preferred substitute to USD LIBOR
    - A broad overnight rate based on repo financing rates
    - Unlike LIBOR—SOFR is a secured rate index
  - In July 2017 the UK Financial Conduct Authority ("FCA") announced that it will no longer compel or persuade banks to submit to LIBOR panels after the end of 2021(i.e., December 31, 2021)
    - The FCA has indicated that panel banks may voluntarily provide LIBOR data until the end of 2021

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Asset Classes Affected

Table 1: Estimated USD LIBOR Market Footprint by Asset Class[1]

		Volume (Trillions USD)	Share Maturing By: End 2021	End 2025	After 2030	After 2040
Over-the-Counter Derivatives	Interest rate swaps	81	66%	88%	7%	5%
	Forward rate agreements	34	100%	100%	0%	0%
	Interest rate options	12	65%	68%	5%	5%
	Cross currency swaps	18	88%	93%	2%	0%
Exchange Traded Derivatives	Interest rate options	34	99%	100%	0%	0%
	Interest rate futures	11	99%	100%	0%	0%
Business Loans[2]	Syndicated loans	1.5	83%	100%	0%	0%
	Nonsyndicated business loans	0.8	86%	97%	1%	0%
	Nonsyndicated CRE/Commercial mortgages	1.1	83%	94%	4%	2%
Consumer Loans	Retail mortgages[3]	1.2	57%	82%	7%	1%
	Other Consumer loans	0.1	—	—	—	—
Bonds	Floating/Variable Rate Notes	1.8	84%	93%	6%	3%
Securitizations	Mortgage -backed Securites (incl. CMOs)	1.0	57%	81%	7%	1%
	Collateralized loan obligations	0.4	26%	72%	5%	0%
	Asset-backed securities	0.2	55%	78%	10%	2%
	Collateralized debt obligations	0.2	48%	73%	10%	2%
Total USD LIBOR Exposure:		**199**	**82%**	**92%**	**4%**	**2%**

[1] Source: Federal Reserve staff calcuations, BIS, Bloomberg, CME, DTCC, Federal Reserve Financial Accounts of the Unites States, G.19, Shared National Credit, and Y-14 data, and JPMorgan Chase . Data are gross notional exposures as of year-end 2016. [2] The figures for syndicated and corporate business loans do not include undrawn lines. Nonsyndicated business loans exlucde CRE/commercial mortgage loans.[3] Estimated maturities based on historical pre-payment rates

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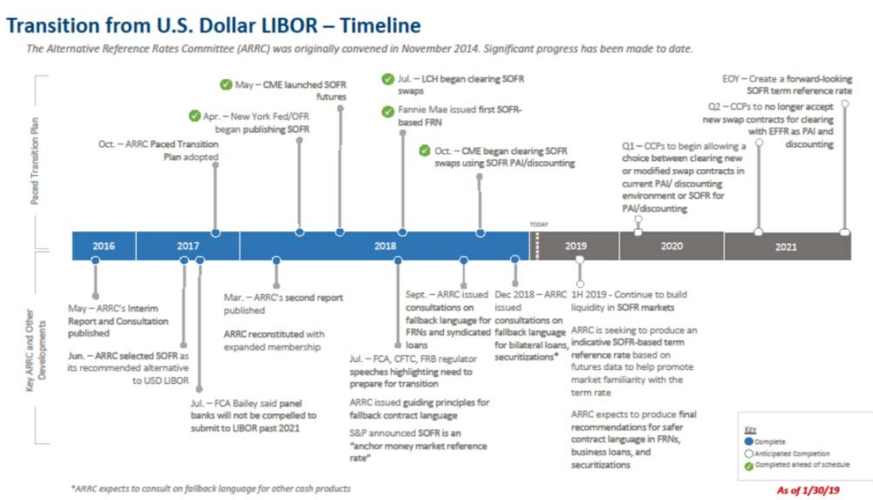
LIBOR PROJECT PLAN AND ANALYSIS

Timetable



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LIBOR PROJECT PLAN AND ANALYSIS

Substitution Alternatives

- ***Secured Overnight Financing Rate*** **("SOFR")**
  - **Overnight, nearly "risk free" rate that is correlated with other money market rates**
  - **Fully transaction based, reflecting broad measure of overnight US Treasury repurchase ("Repo") financing transactions (tri-party repo, FICC GCF repo, FICC bilateral treasury repo)**
  - **Encompasses robust underlying market with over $650 billion in daily transactions**
  - **NY Fed proposes to use a volume-weighted median as the central tendency measure for SOFR and to publish summary statistics to accompany the daily publication of the rate**
  - **SOFR is published each business day at 8:00 AM EST**
  - **Recently several regional banks objected to SOFR as a viable reference rate replacement**
    - https://www.politico.com/f/?id=0000016d-d15d-d0d8-af6d-f77d6c5f0001

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Other Substitution Alternatives

- **SONIA—Reformed Sterling Overnight Index Average**
  - **Based on unsecured overnight transactions negotiated bilaterally and arranged with brokers**
- **TONAR—Tokyo Overnight Average Rate**
  - **Based on transactions executed in the unsecured overnight call rate market**
- **SARON—Swiss Average Rate Overnight**
  - **Based on secured transactions in the interbank overnight Swiss repo market**
- **EONIA—Euro Over Night Index Average**
  - **Based upon average interest rate at which a selection of European banks lend one another in euros with a maturity of one day**
- **The ICE Benchmark Administration has announced its effort to calculate and announce a modified LIBOR (good luck on that one…)**
- **Ameribor—Created by American Financial Exchange (AFX)**
  - **Reflects borrowing costs of more than 100 U.S. small- and mid-sized banks using a 30-day rolling average of the weighted average daily volume in the AFX overnight unsecured market**

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Stakeholders/Participants

- **ARRC**
- **FRB**
- **ISDA**
- **Federal Prudential Bank Regulators**
- **FASB**
- **IOSCO**
- **British Regulatory Authorities**
    - **Prudential Regulation Authority**
    - **Financial Conduct Authority**
    - **ICE Benchmark Administration**
    - **Financial Stability Board**

Focused Attention: Four Core Concepts

- ***Trigger*—The event that requires the replacement of one index with another**
- ***Fallback*—Assuming that a triggering event occurs, what the instrument provides will happen with respect to the replacement of one index with another**
- ***Index*—This is the reference rate that is used to set the base rate for an adjustable rate instrument, which adjusts from time to time, and that determines in part, what the debtor will pay**
    - **The index that is disappearing is LIBOR**
- ***Margin*—Usually expressed in terms of basis points, the spread over (or under) the index which produces the interest rate that the debtor is required to pay from time to time**

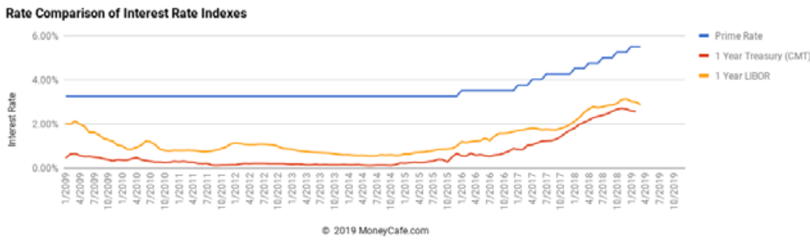
Cessation Analysis: Basic Concepts

- When a triggering event occurs, LIBOR as the index gets replaced by a new index
  - The ARRC has recommended SOFR as the successor rate for U.S. dollar contracts
- LIBOR is a rate that contains a credit component, while SOFR is based upon secured financings where the security consists of U.S. Treasury and agency securities, and is considered a risk-free rate
- Because of the difference in nature, the ARRC has recognized the importance of a so-called "spread adjustment"
  - The spread adjustment would adjust for credit risk embedded in LIBOR, and for a number of other differences between LIBOR and SOFR.
  - ARRC Consultation, "Regarding More Robust LIBOR Fallback Contract Language For new Issuances of LIBOR Floating Rate Notes" (Sept. 24, 2018)
    - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-FRN-Consultation.pdf
  - ARRC Consultation, "Frequently Asked Questions" (Oct. 29, 2018)
    - https://www.newyorkfed.org/arrc/faq

Moving From an Index Containing Credit Risk to a Risk Free Rate

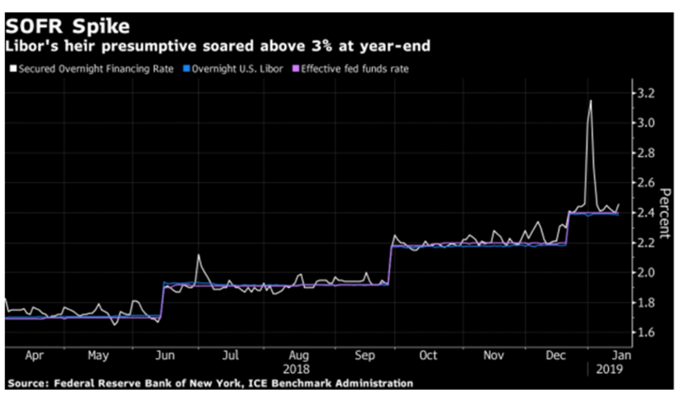
- A simple move from LIBOR to SOFR would likely result in a move to a lower index
- If the margin remains constant, the debtor will have a lower financing cost, meaning this change would result in a debtor gain equivalent to the value adjustment
- Alternatively, if the instrument (i.e., contract terms) permits, the margin could be adjusted to avoid the transfer of value from creditor to debtor
  - The absence of contract terms permitting the margin to be adjusted may be the most significant litigation risk created by the LIBOR issue
- Thankfully, the IRS has issued a proposed rule that would significantly lessen the effect of an index substitution and not require a recognition of gain or loss
  - https://www.federalregister.gov/documents/2019/10/09/2019-22042/guidance-on-the-transition-from-interbank-offered-rates-to-other-reference-rates#h-20

Illustration: Risk Free Rate vs. LIBOR

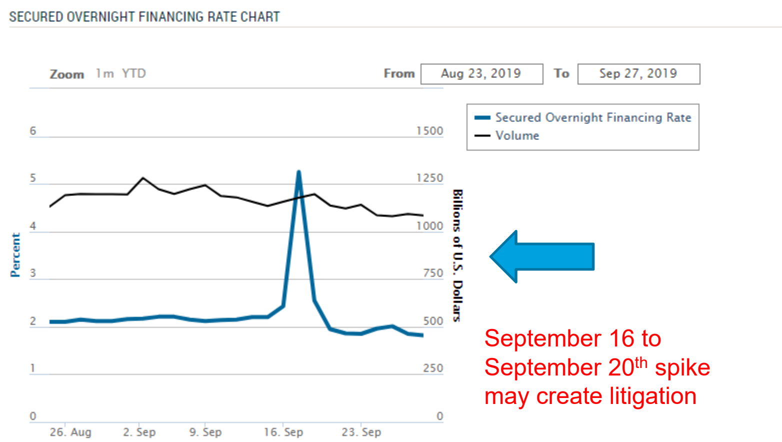


1-Year Treasury CMT is a risk-free rate.
LIBOR and Prime have a credit component.

Potential Volatility of SOFR vs. LIBOR



80 basis point disparity in December 2018



ARRC Publications and Advice

- The ARRC has issued numerous papers and proposed approaches to address the LIBOR substitution issue
- Several of the more important ARRC published materials are referenced at the end of this presentation
  - A complete listing can be found at: https://www.federalregister.gov/documents/2019/10/09/2019-22042/guidance-on-the-transition-from-interbank-offered-rates-to-other-reference-rates#h-20
- The ARRC has issued several documents on proposed language based upon credit products—
  - Adjustable Rate Mortgages
  - Bilateral Business Loans
  - Floating Rate Notes
  - Securitizations, and
  - Syndicated Loans
- While helpful—virtually no ARRC advice addresses litigation exposure…

A Project Plan Approach

- Analyze risk, plan for implementation
  - Identification of bank assets impacted by LIBOR
    - Estimating run-off for legacy instruments
    - Evaluating existing LIBOR replacement language
  - Adoption of a comprehensive substitution scheme
  - Drafting of LIBOR substitution language
    - New lending
    - Legacy loans and credit instruments
    - Consumer loans
  - Adoption of substitution language
  - Strategic litigation planning
    - Some areas of risk may only permit identifying likely plaintiffs

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Project Plan Tools

- Dorsey has available a project plan organizing document
- The ARRC has issued an implementation checklist for SOFR adoption
  - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-SOFR-Checklist-20190919.pdf
- Use artificial intelligence ("AI") to make document review faster and more cost-efficient
  - https://www.dorsey.com/services/legal_mine employs analytics that include use of AI
  - Kira (AI contract clause identification and extraction), and
  - Nuix Discover (AI and other advanced technologies to predict responsive documents)

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Project Plan—Assets Impacted by LIBOR

- Identify categories of LIBOR-impacted assets and functions
  - Commercial loans
  - Consumer loans
  - Secondary market transactions
  - Corporate Trust functions
  - Servicing functions
- Identify classes of LIBOR instruments within those categories
  - Run-off prior to 2022
  - Run-off within specified time periods commencing in 2022
- Analyze and categorize contract language for legacy instruments to identify—
  - Effective substitution language
  - Ambiguous or incomplete substitution language
    - Note that the "old" fallback language that has been included in loan documents for years is not sufficient; it contemplates a temporary cessation or inability to determine LIBOR rather than a permanent cessation, and the usual fallback to and ABR or prime will substantially alter the economics
  - Absence of margin adjustment authority

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Project Plan—Adoption of a Comprehensive Substitution Scheme

- Decide which replacement index will be used for which asset categories.
  - SOFR? Another rate? If SOFR, which of the four conventions?
- Plan for what this will look like on an operational level.

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Project Plan—Draft LIBOR Substitution Language

- **Multiple versions of form LIBOR substitution language should be prepared based on:**
  - Type of instrument
    - New loan instruments (*i.e.*, going forward)
    - Amending existing instruments (*i.e.*, when permitted)
  - Complexity of substitution language appropriate for the instrument
    - ARRC proposed lending documentation generally viewed as overly complex except for large credits
      - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Bilateral-Business-Loans-Consultation.pdf
    - LSTA endorses the ARRC language; syndicated markets are starting to adopt ARRC language
    - Large institutional lenders have substantially consistent language being used for the Amendment Approach

Project Plan—Draft LIBOR Substitution Language

- Determination of whether to include hard-wired substitution language or an amendment approach and the timing for when to transition from amendment approach to hard-wired
  - Hardwired Approach
    - Language included in loan documents provides that a specific replacement index (i.e., the SOFR) will be applied upon a "triggering event" (defined as "benchmark transition event")
    - May include—
      - » Public statement by administrator or regulatory supervisor of LIBOR announcing the index has ceased (provided that no successor index has been announced), or
      - » Public statement by the administrator or regulatory supervisor that LIBOR is no longer reliable)
  - Amendment Approach
    - Language included in loan documents provides upon a "triggering event" that the lender may amend the loan documents to substitute a replacement index, and will become effective on a specified date (or could set a future effective date if no objection received from borrower

An Exemplar—the ARRC Bilateral Business Loan Substitution Language

ARRC DRAFT AMENDMENT APPROACH FALLBACK LANGUAGE FOR NEW ORIGINATIONS OF LIBOR BILATERAL BUSINESS LOANS

Effect of Benchmark Discontinuance Event

(a) Notwithstanding anything to the contrary in this Agreement or any other Loan Document, at or promptly after a Benchmark Transition Determination, the Lender pursuant to clause (b) of this Section titled "*Effect of Benchmark Discontinuance Event*" may amend this Agreement to replace LIBOR with an alternate benchmark rate (which may include Term SOFR, to the extent publicly available quotes of Term SOFR exist at the relevant time), including any Replacement Benchmark Spread, in each case giving due consideration to [any evolving or then existing convention for similar U.S. dollar denominated credit facilities for such alternative benchmarks and adjustments or] any selection, endorsement or recommendation by the Relevant Governmental Body with respect to such facilities (any such proposed rate, together with the Replacement Benchmark Spread, a "*Replacement Benchmark*"). Such Replacement Benchmark shall be applied in a manner consistent with market practice or, to the extent such market practice is not administratively feasible for the Lender, in a manner as otherwise reasonably determined by the Lender; provided that in no event shall such Replacement Benchmark be less than zero for purposes of this Agreement.

An Exemplar—the ARRC Bilateral Business Loan Substitution Language

(b) Any such amendment with respect to an event under clause (1) or (2) of the definition of "Benchmark Transition Determination" shall become effective upon the Lender's determination to seek such amendment and the passage of [five (5)][ten (10)] Business Days following the receipt of such amendment by the Borrower specifying the terms of such amendment including, without limitation, the Replacement Benchmark, (including the Replacement Benchmark Spread)[, unless, prior to the passage of such time, the Borrower has delivered written notice to Lender that it does not accept such amendment]. No replacement of LIBOR with a Replacement Benchmark pursuant to this Section titled "Effect of Benchmark Discontinuance Event" shall occur (i) prior to the applicable Benchmark Transition Start Date or (ii) prior to the effective date for such replacement, if any, specified in such amendment.

(c) The Lender will promptly notify Borrower of the occurrence of any Benchmark Unavailability Period. The Borrower may revoke any request for a Eurodollar Borrowing of, conversion to or continuation of Eurodollar Loans to be made, converted or continued during any Benchmark Unavailability Period and, if no such revocation is timely sent by the Borrower, the Borrower will be deemed to have converted any such request into a request for a Borrowing of or conversion to ABR Loans (subject to the next sentence). During any Benchmark Unavailability Period, the LIBO Rate component shall not be used in any determination of ABR.

ARRC Bilateral Business Loan Substitution Language (Continued)

(d) The Lender shall have the right upon making a Benchmark Transition Determination [from time to time] to make any Replacement Benchmark Conforming Changes and, notwithstanding any other provision of this Agreement to the contrary, any amendment[s] implementing such Replacement Benchmark Conforming Changes shall become effective without any further action or consent of the Borrower.

(e) As used in this Section titled "Effect of Benchmark Discontinuance Event" :

Benchmark Discontinuance Event" means the occurrence of one or more of the following events with respect to LIBOR:

(1) a public statement or publication of information by or on behalf of the administrator of LIBOR announcing that such administrator has ceased or will cease to provide LIBOR, permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide LIBOR;

(2) a public statement or publication of information by the regulatory supervisor for the administrator of LIBOR, the U.S. Federal Reserve System, an insolvency official with jurisdiction over the administrator for LIBOR, a resolution authority with jurisdiction over the administrator for LIBOR or a court or an entity with similar insolvency or resolution authority over the administrator for LIBOR, which states that the administrator of LIBOR has ceased or will cease to provide LIBOR permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide LIBOR;

ARRC Bilateral Business Loan Substitution Language (Continued)

(3) [a LIBOR rate is not published by the administrator of LIBOR for five consecutive Business Days and such failure is not the result of a temporary moratorium, embargo or disruption declared by the administrator of LIBOR or by the regulatory supervisor for the administrator of LIBOR;]

(4) [a public statement or publication of information by the administrator of LIBOR that it has invoked or will invoke, permanently or indefinitely, its insufficient submissions policy; or]

(5) [a public statement by the regulatory supervisor for the administrator of LIBOR or any Governmental Authority having jurisdiction over the Lender announcing that LIBOR is no longer representative or may no longer be used.]

"*Benchmark Replacement Date*" means (a) for purposes of clauses (1) and (2) of the definition of "Benchmark Discontinuance Event," the later of (i) the date of such public statement or publication of information and (ii) the date on which the administrator of LIBOR permanently or indefinitely ceases to provide LIBOR, (b) for purposes of clause (3) of the definition of "Benchmark Discontinuance Event," the first Business Day following such five consecutive Business Days, (c) for purposes of clause (4) of the definition of "Benchmark Discontinuance Event," the later of (i) the date of such public statement or publication of information and (ii) the date such insufficient submissions policy is invoked, and (d) for purposes of clause (5) of the definition of "Benchmark Discontinuance Event," the later of (i) the date of such public statement and (ii) the date as of which LIBOR may no longer be used (or, if applicable, is no longer representative).

Project Plan—Draft LIBOR Substitution Language

- Draft amendment language for other provisions of the instrument to account for the secondary effect of LIBOR substitution on other provisions of the agreement
  - Ex. Prepayment language, breakfunding, Business Day definition, etc.
  - The LSTA has distributed a SOFR Concept Credit Agreement using SOFR and is seeking input from market participants. It is based on the Compounded SOFR in Arrears convention.

Project Plan – Implement LIBOR Substitution Language

- The Implementation Phase will be intensive
  - For new deals, LIBOR substitution language will be built into the new documents.
  - For legacy deals, LIBOR substitution language will need be built in by amendment, which for most instrument types will mean requiring Borrower sign-off.
    - LIBOR will no longer be available at the end of 2021, if not sooner. This will mean a large volume of amendments to coordinate.
  - Remember – If the "Amendment Approach" is taken, building in Amendment Approach substitution language is only the first step; the agreement will need further amended at the time of the triggering event to build in the substitution language.

Project Plan – Strategic Litigation Planning

- Evaluate legal risks inherent in the substance and inherent in the process
- See further discussion later under “Litigation Risk”

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Corporate Trust Functions

- Corporate trustees provide trustee and agency services for notes offerings and lending transactions which involve numerous asset categories potentially affected by LIBOR including—
  - Floating rate notes (corporate notes, municipal bonds)
  - MBS, CMBS and asset backed securitizations
  - CLOs
  - Syndicated loans (loan agent function)
  - CRE/Commercial mortgages

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Corporate Trust – Fallback Language

AARC has recommended fallback language for new issuances of LIBOR-referenced floating rate notes

- **Benchmark Replacement:** ***If the issuer or its designee determines that a Benchmark Transition Event and its related Benchmark Replacement Date have occurred prior to the Reference Time in respect of any determination of the Benchmark on any date, the Benchmark Replacement will replace the then-current Benchmark for all purposes relating to the Notes in respect of such determination on such date and all determinations on all subsequent dates.***
- **Legacy contracts**
- **New contracts**

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Corporate Trust- Special Risk Issues

- **A corporate trustee's and agent's authority, rights and obligations are governed by the transaction documents**
  - **Legacy contracts might require the Trustee to determine LIBOR in its capacity as Trustee or Calculation Agent**
  - **Amendments that adversely effect payment terms require consent of all of the effected holders**
    - **It may not be clear from the transaction documents whether consent of a majority of holders or all of the holders will be required**
    - **Trust Indenture Act considerations**
    - **Practical considerations of obtaining consent – notes are typically held through DTC or other depository**
  - **A trustee may be faced with contrary or ambiguous substitution instructions**
  - **Potentially any act or failure to act by a bank trustee may create litigation exposure**

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Trust Instructions Proceedings (“TIPs”)

- **Recommendation:**
  - Bring declaratory judgment actions:
    - “TIPs” actions—to obtain court direction for resolving LIBOR obligations
    - Alternative to TIPS–Article 77 of the CPLR
- **When TIPs are used:**
  - Action is needed to:
    - resolve a dispute, error or uncertainty regarding the terms of an indenture or other trust instrument;
    - remedial action is necessary; or
    - a dispute arises between groups of holders
  - and in each case the trustee is unwilling to act due to uncertainty or the lack of requisite noteholder direction and indemnity

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LIBOR PROJECT PLAN AND ANALYSIS

Trust Instruction Proceedings (“TIPs”) Cont’d

- **Under Minn. Stat. section 501C.0202, a TIP may be filed to:**
  - (1) to confirm an action taken by a trustee
  - (4) to construe, interpret, or reform the terms of a trust, or authorize a deviation from the terms of a trust
  - (24) to instruct the trustee, beneficiaries and any other interested parties in any matter relating to the administration of the trust and discharge of the trustee’s duties

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Benefits of TIPs and TIP Alternatives

- **Benefits of TIPs:**
  - Provides protection to the trustee—prudent person standard is deemed met when complying with a court order
  - Provides a controlled forum for all points of view to be heard
  - Allows parties to seek redress without necessarily delivering an indemnity
  - Provides mechanism to address issues never contemplated by the trust instrument
- **Alternatives to TIPS – CPLR Article 77:**
  - Article 77 of the CPLR gives NY Supreme Court jurisdiction over cases involving most trusts, and allows the case to proceed as a "special proceeding" under CPLR Article 4
  - A special proceeding is a streamlined procedural format more akin to a motion than a full litigation

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Investment Management

- **Identify and inventory instruments in clients' accounts referencing LIBOR—**
  - Floating rate debt
  - Bank loans,
  - LIBOR-linked derivatives, and
  - Asset-backed securities
- **Assess the impact the discontinuation of LIBOR will have on these investments, agreements and arrangements**
- **Develop an action plan for selecting an appropriate alternative reference rate**
- **Develop policies and procedures which will govern the transition away from LIBOR and amend existing policies and procedures which will be impacted by the same**
- **Develop additional or enhanced risk disclosures relating to the transition away from LIBOR to be made to investors and clients as appropriate**
  - The SEC staff encourages affected investment funds to provide investors with tailored risk disclosure that specifically describes the impact of the transition on their holdings

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Consumer Loans

- **ARRC estimates there will be $1.2 trillion of consumer mortgages using LIBOR as of 2021**
  - **Approximately $800 billion will remain outstanding as of 2025**
  - **The GSEs have finally stopped purchasing LIBOR-based mortgage loans**
  - **The analysis for LIBOR index substitution may be significantly different than the methodology to be employed by the commercial financial market**

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Specific Illustration:
Fannie Mae Form Adjustable Rate Note

ADJUSTABLE RATE NOTE

(LIBOR One-Year Index (As Published In *The Wall Street Journal*)—Rate Caps)

THIS NOTE CONTAINS PROVISIONS ALLOWING FOR CHANGES IN MY INTEREST RATE AND MY MONTHLY PAYMENT. THIS NOTE LIMITS THE AMOUNT MY INTEREST RATE CAN CHANGE AT ANY ONE TIME AND THE MINIMUM AND MAXIMUM RATES I MUST PAY.

4. INTEREST RATE AND MONTHLY PAYMENT CHANGES

(A) Change Dates

The interest rate I will pay may change on the first day of ______________________, ________, and on that day every 12th month thereafter. Each date on which my interest rate could change is called a "Change Date."

(B) The Index

Beginning with the first Change Date, my interest rate will be based on an Index. The "Index" is the average of interbank offered rates for one-year U.S. dollar-denominated deposits in the London market ("LIBOR"), as published in *The Wall Street Journal*. The most recent Index value available as of the date 45 days before each Change Date is called the "Current Index," provided that if the Current Index is less than zero, then the Current Index will be deemed to be zero for purposes of calculating my interest rate.

The Index: LIBOR

The Trigger

If the Index is no longer available, the Note Holder will choose a new index which is based upon comparable information. The Note Holder will give me notice of this choice.

Fallback

(C) Calculation of Changes

Before each Change Date, the Note Holder will calculate my new interest rate by adding ____________________ percentage points (___________%) (the "Margin") to the Current Index. The Note Holder will then round the result of this addition to the nearest one-eighth of one percentage point (0.125%). Subject to the limits stated in Section 4(D) below, this rounded amount will be my new interest rate until the next Change Date.

Margin

The Note Holder will then determine the amount of the monthly payment that would be sufficient to repay the unpaid principal that I am expected to owe at the Change Date in full on the Maturity Date at my new interest rate in substantially equal payments. The result of this calculation will be the new amount of my monthly payment.

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Consumer Mortgage Substitution—Variable-Rate Banking Authority

National Banks—12 C.F.R. §34.22—Index.

(a) *In general.* If a national bank makes an ARM loan to which 12 CFR 226.19(b) applies (*i.e.,* the annual percentage rate of a loan may increase after consummation, the term exceeds one year, and the consumer's principal dwelling secures the indebtedness), the loan documents must specify an index or combination of indices to which changes in the interest rate will be linked. ***This index must be readily available to, and verifiable by, the borrower and beyond the control of the bank.*** A national bank may use as an index any measure of rates of interest that meets these requirements.

Consumer Mortgage Substitution—Variable-Rate Banking Authority

State Lenders—12 C.F.R §1004.1—Alternative Mortgage Transaction Parity Act—Authority, purpose, and scope.

(a) *Authority.* This regulation, known as Regulation D, is issued by the Bureau of Consumer Financial Protection to implement the Alternative Mortgage Transaction Parity Act, 12 U.S.C. 3801 *et seq.,* as amended by title X, Section 1083 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, 124 Stat. 1376). Section 1004.4 is issued pursuant to the Alternative Mortgage Transaction Parity Act (as amended) and the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*

....

12 C.F.R. §1004.4 Requirements for alternative mortgage transactions.

(a) Mortgages with adjustable rates or finance charges and home equity lines of credit. A creditor that makes an alternative mortgage transaction with an adjustable rate or finance charge may only increase the interest rate or finance charge as follows:

…

(2) For all other transactions, *the creditor must use either:*

(i) An index to which changes in the interest rate are tied that is readily available to and verifiable by the borrower and beyond the control of the creditor;…

Litigation Risk

- Plaintiff-side firms looking for next big thing
- The rise of litigation funding
- Multiple theories of liability
  - Contract claims by borrowers
    - Damages
    - Rescission or reformation?
  - Tort
    - Fiduciary duty
  - Securities claims by shareholders
    - Inadequate risk disclosures
    - Valuation of preferred shares tied to LIBOR
  - Antitrust claims against industry leaders
- Likelihood of forum shopping
- What will regulators do?

Risk Analysis

- Identify legacy contracts
- Identify language weaknesses
  - "fallback" provisions
  - "no longer available"
  - "based on comparable information"
  - Spread adjustment mechanism (or not)
- Quantify magnitude of exposure by asset class
  - Commercial
  - Consumer
  - Trustee
- Develop enterprise-wide approach to risks
- Develop communication strategy for dealing with customers and counterparties

Affirmative Litigation Strategy

- **Identify borrowers (asset classes) with best fallback language**
- **Select favorable forum**
- **Use declaratory judgment claims**
- **Consider potential efficacy of MDL proceedings**

Prior Litigation Cases Are Not Very Helpful

- ***FDIC v. 272 Post Rd. Associates*, No. 5:91: CV: 433, WL 902825 (D. Conn 1994)**
- ***Ginsberg 1985 Real Estate Partnership v. Cadle Co.*, 39 F. 3rd 528 (5th Cir. 1994)**
- ***New Whitehall Apartments v. S.A.V. Associates Inc.*, 56 Misc.3d 101 (2017), 59 N.Y.S.3d 874, 2017 WL 2854667, 2017 N.Y. Slip Op. 27221**

Speakers

Mark Jutsen – Dorsey & Whitney LLP

Mark is a finance and restructuring lawyer based in Dorsey's New York office. He has dedicated his practice to corporate finance representing banks as Corporate Trustee, Collateral Agent, Escrow Agent, Loan Administrative Agent and numerous other agency capacities, and as Custodian in a broad range of debt capital markets, project finance and lending transactions across all product lines. Mark has handled debt finance transactions across a broad range of industries including mining, energy, gaming, banking, shipping transportation and manufacturing. Mark has a particular focus on representing Trustees and Collateral Agents in secured corporate debt transactions, project finance, and loan agency matters. His practice covers domestic, cross border and global transactions. Mark also has extensive experience in asset backed securitization including residential mortgage backed securities. He can be contacted via email at jutsen.mark@dorsey.com or at (212) 415-9335.

Speakers

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Jim has more than 30 years of experience representing public companies, banks, mortgage lenders, insurance companies, investment banks, and broker-dealers in litigated disputes in federal and state courts as well as before regulatory agencies, particularly the SEC. Jim is a Fellow of the American College of Trial Lawyers and has extensive first-chair trial experience in federal and state courts, as well as in arbitration forums (including FINRA, AAA and UNCITRAL) and before regulatory agencies. Jim is co-Head of the Class Action Practice Group. His practice focuses on all aspects of financial services litigation, including class actions, shareholder derivative actions, claims related to mortgage-backed securities, securities arbitrations (customer and intra-industry), tender offer defense and regulatory investigations and enforcement actions. He can be contacted via email at langdon.jim@dorsey.com or at (612) 340-8759.

Speakers

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Speakers

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Betsy represents both lenders and borrowers in varied aspects of commercial finance, including syndicated credit facilities, merger and acquisition financing, asset-based lending, and real estate loans. Betsy also represents individual and institutional clients in connection with lending aspects of wealth management, foundation loans, Grantor Retained Annuity Trust (GRAT) loans, and other loans to individuals. She is also experienced with Indian and gaming financing transactions, particularly in connection with the construction and expansion of casino and entertainment facilities and the finance of leased gaming equipment. Betsy's practice includes representations in connection with term loan facilities, revolving loan facilities, letter of credit facilities, syndicated and participated loans, subordinated loans, secured and unsecured transactions. She can be contacted via email at parker.betsy@dorsey.com or at (612) 492-6028.

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Questions?

LIBOR PROJECT PLAN AND ANALYSIS

Reference Materials

- **Dorsey Alerts and other Dorsey materials—**
  - **Preparing for LIBOR Substitution-Commercial and Consumer Lending Considerations**
    - https://www.dorsey.com/newsresources/publications/client-alerts/2019/09/preparing-for-libor-substitution
  - **The Discontinuation Of LIBOR - The Top Five Things Investment Managers Should Consider**
    - https://www.dorsey.com/newsresources/publications/client-alerts/2019/10/the-discontinuation-of-libor
  - **What the LIBOR Phase-out Means for Debt Capital Market Participants**
    - https://www.dorsey.com/newsresources/publications/client-alerts/2019/04/the-libor-phase-out
  - **SEC Staff Publishes Statement on Risks of Transition Away from LIBOR**
    - https://www.dorsey.com/newsresources/publications/client-alerts/2019/07/risks-of-transition-away-from-libor

LIBOR PROJECT PLAN AND ANALYSIS

Reference Materials

- **Alternative Reference Rates Committee**
  - https://www.newyorkfed.org/arrc
  - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf
  - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Bilateral-Business-Loans-Consultation.pdf
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  - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/SEC_Feedback_About_Relief_on_Preferred_Shares.pdf
  - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-July-9-2018-announcement
  - https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/LIBOR_Fallback_Language_Summary

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