Regulatory Alert

Regulatory Insights

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Transition away from LIBOR

Key points

- Federal and state financial regulators stress that the end dates for LIBOR are definitive and immovable.
- Supervised institutions may not enter into new contracts referencing LIBOR after December 31, 2021; exceptions in limited circumstances.
- Supervised institutions should conduct due diligence to ensure that selected alternative reference rates are appropriate for the institution's products, risk profile, risk management capabilities, customer and funding needs, and operational capabilities.
- Multiple regulators have identified the transition to alternative reference rates and the cessation of LIBOR as a supervisory and strategic priority.

The Federal Reserve Board (FRB) recently stated that "reviewing banks' cessation of LIBOR use after year-end will be one of the highest priorities of … bank supervisors in the coming months."

Similarly, the Office of the Comptroller of the Currency (OCC) identified the transition to alternative reference rates and the cessation of LIBOR as a strategic priority in its fiscal year 2022 supervision operating plan. OCC states that examiners will look at banks' implementation and execution of alternative reference rates, expect them to fully understand all their exposures, and to be nearly complete with remediation efforts. Examiners will also look at banks' operational, reputation, and consumer impact assessments and change management related to an alternative index for pricing loans, deposits, and other products and services.

Five federal financial institution regulatory agencies (FRB, OCC, FDIC, CFPB, and NCUA) along with state bank and state credit union regulators (collectively, the Agencies) have now issued a joint statement emphasizing the importance of an orderly transition away from LIBOR.

The Agencies reiterate that the:

- United Kingdom Financial Conduct Authority (FCA) and Intercontinental Exchange (ICE) Benchmark Administration (IBA) have announced that the one-week and two-month U.S. dollar (USD) LIBOR settings will cease to be published immediately after December 31, 2021.
- Publication of overnight and one-, three-, six-, and 12-month USD LIBOR settings will be extended through June 30, 2023, which will provide additional time to wind down or renegotiate existing contracts that reference these LIBOR settings.
- Federal financial institution agencies have published guidance that encourages institutions to cease entering into new contracts that reference USD

LIBOR as soon as practicable but no later than December 31, 2021 (subject to limited exceptions).

With regard to "new contracts," the Agencies clarify that:

— "New contracts" would include an agreement that (i) creates additional LIBOR exposure for a supervised institution or (ii) extends the term of an existing LIBOR contract.
— A draw on an existing agreement that is legally enforceable (e.g., a committed credit facility) would not be viewed as a new contract.
— Contracts entered into on or before December 31, 2021, should either use a reference rate other than LIBOR or have fallback language that provides for use of a strong and clearly defined alternative reference rate after LIBOR's discontinuation.
— Supervised institutions should conduct due diligence to ensure that alternative rate selections are appropriate for the supervised institution's products, risk profile, risk management capabilities, customer and funding needs, and operational capabilities.

Concerning the use of SOFR, the FRB further clarified that:

— Given the availability of SOFR, including term SOFR, there will be no reason for a bank to use LIBOR after 2021 while trying to find a rate it likes better.
— It is critical that capital markets and derivatives markets transition to SOFR; ARRC did not recommend any other rate for capital markets or derivatives, and market participants should not expect such rates to be widely available.
— A bank may use SOFR for its loans, but it may also use any reference rate for its loans that the bank determines to be appropriate for its funding model and customer needs.

Supervisory institutions are encouraged to:

— Identify all contracts that reference LIBOR, lack adequate fallback language, and will mature after the relevant tenor ceases.
— Develop and implement a transition plan for communicating with consumers, clients, and counterparties.
— Ensure systems and operational capabilities will be ready for transition to a replacement reference rate after LIBOR's discontinuation.
— Anticipate supervisory focus and review will continue to increase as the June 30, 2023 LIBOR cessation date approaches.

Relevant links:

— FRB speech, "Goodbye to all that: The end of LIBOR," is available here.
— OCC Supervision Operating Plan, FY 2022, is available here.
— Joint Statement on Managing the LIBOR Transition is available here.
— ARRC (Alternative Reference Rates Committee) releases are available here.
— KPMG Regulatory Alert, LIBOR Transition: Anticipate supervisory findings and actions, is available here.

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