Fall 2020 LIBOR Transition LinkWrap: A Compendium of Recent Developments

Friedman Kaplan LIBOR Transition Task Force

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What's happening right now in the world of LIBOR transition? Friedman Kaplan's LIBOR Transition Task Force sees five major themes:

1. The FCA has made clear that the COVID-19 crisis has not changed the timeline for the end of compelled submissions to USD LIBOR as of December 31, 2021, although some intermediate milestones have been delayed.

Since the beginning of the COVID-19 pandemic in the first quarter of 2020, there have been questions whether the UK's Financial Conduct Authority, which regulates USD LIBOR, would push back LIBOR's December 31, 2021 end date. While some sources have suggested the possibility of a delay, and some market participants continue to hope for a delay, the official sector continues to reinforce the FCA's message from earlier in the year that there will be no delay.

Other official sector organizations have chimed in to confirm the FCA's message. In July, Bank of England Governor Andrew Bailey confirmed that, "Plans now need to be in place to transition from Libor to alternative reference rates by end 2021. … With 18 months to go these plans must now be acted upon in the time remaining." Indeed, in June, the UK FCA announced that it may begin the process of giving notice that LIBOR is no longer "representative," ensuring its ultimate demise at the end of 2021, as early as the time when the ISDA protocol process (discussed below) is completed and potentially even before the end of 2020.

In July, the Financial Stability Board issued a statement on benchmark transition in light of COVID- 19, confirming it "maintains its view that financial and non-financial sector firms across all jurisdictions should continue their efforts in making wider use of risk-free rates in order to reduce reliance on IBORs where appropriate and in particular to remove remaining dependencies on LIBOR by the end of 2021." In September, as some employers began returning to the office to some degree, the FCA's Edwin Schooling Latter said in an interview that, "I would like people to be coming back to the office aware that the months ahead are a critical period for them to act" on LIBOR transition plans.

In light of these strong messages that LIBOR transition is continuing full speed ahead, and the fact that the end of 2021 is now approximately 15 months (less than 500 days) away, market participants must take LIBOR transition seriously and act to address it. As one commentator wrote, "bankers need to lock in their talent, … get their technology strategy ready … [and] transition into execution mode." The same can be said for all market participants.

Although the end-2021 deadline has not moved, some interim work on LIBOR transition has been delayed. The ARRC twice extended the due date for its consultation on LIBOR fallback language for new variable rate private student loans, and also extended the due date for the consultation on a supplemental spread adjustment. (There currently are no open ARRC consultations.)

2. The official sector continues to work on measures to facilitate the transition away from LIBOR.

Consistent with the messages from LIBOR's regulator the UK FCA, official sector and industry groups both in the US and the UK continue to move ahead with transition work:

At the end of May, the ARRC published recommended best practices to assist market participants in preparing for USD LIBOR cessation, including recommended timelines and intermediate steps market participants can take to achieve a successful transition, summarized in this table:

Product	Hardwired Fallbacks Incorporated By	Tech/Ops Vendor Readiness By	Target For Cessation Of New Use Of USD LIBOR By	Anticipated Fallback Rates To Be Identified By
Floating Rate Notes	6/30/2020	6/30/2020	12/31/2020	6 months prior to reset after LIBOR's end
Business Loans	9/30/2020	9/30/2020	6/30/2021	6 months prior to reset after LIBOR's end
Consumer Loans	Mortgages: 6/30/2020 Student Loans: 9/30/2020	Mortgages 9/30/2020	Mortgages 9/30/2020[2]	In accordance with relevant consumer regulations
Securitizations	6/30/2020	12/31/2020	CLOs: 9/30/2021 Other: 6/30/2021	6 months prior to reset after LIBOR's end
Derivatives	Not later than 3-4 months after the Amendments to ISDA 2006 Definitions are published	Dealers to take steps to provide liquid SOFR derivatives markets to clients	6/30/2021	

Other work by the ARRC has continued apace. At the end of June, the ARRC released its final recommended contractual fallback language for new variable rate private student loans. In addition, in June and July, the ARRC released updated recommended hardwired fallback language for various products, including syndicated loans, emphasizing the ARRC's preference in favor of the "hardwired" approach rather than the "amendment" approach. The ARRC also announced further details regarding its recommendation of spread adjustments for cash products, following the supplemental spread adjustment consultation noted above.

The ARRC also has embarked on extensive outreach, represented by the public relations firm Brunswick, to publicize the need for action to address LIBOR transition and educate market participants. The ARRC held a series of webinars – the "SOFR Summer Series" – to encourage adoption of SOFR as a replacement for LIBOR. The ARRC also published a "Transition Aid for SOFR Adoption," which classifies LIBOR transition activities into 10 categories and offers lists of steps and activities for market participants to consider, as well as discusses upstream and downstream areas that may be affected by the transition. In August, the ARRC

published a "SOFR Starter Kit," a set of factsheets about LIBOR transition which includes background on the impetus for the transition and the ARRC's work to select a preferred rate, facts and figures about SOFR, and next steps market participants can take.

Thanks to its unique documentation structure for derivatives, ISDA has been able to lead the way in mass amendment of contracts. In June, ISDA published a factsheet on IBOR benchmark fallbacks for derivatives. The factsheet was intended to educate market participants in advance of the publication of a supplement to the 2006 ISDA Definitions to incorporate new fallbacks for derivatives that reference certain IBORs and a protocol for their adoption by derivatives counterparties, which had been planned for July, but now appears to be headed for an October launch. The launch seems to have been delayed primarily by the fact that the US Department of Justice Antitrust Division has not yet released a necessary Business Review Letter. ISDA reports that it submitted the final portion of its request for the BRL in July, somewhat later than expected. (The protocol itself originally had been expected in July.) In late September, ISDA provided an update on its timetable, announcing it now expects the effective date for the protocol to be in mid- to late-January 2021. Once ISDA has completed its work with the US DOJ and other competition authorities, it will give market participants approximately two weeks' notice of the official launch date, during which firms will be able to adhere to the protocol "in escrow." ARRC chair Tom Wipf has urged parties to take this opportunity to sign up on a binding but non-public basis so their adherence takes effect as soon as the protocol launches. The supplement and protocol will officially launch after the escrow period, and will take effect approximately three months later. Those trying to anticipate the launch of ISDA protocol would do well to keep an eye on this page on the DOJ website, where BRLs are published.

While the ISDA protocol has not yet been published for adherence, other pieces of the ISDA transition plan are moving ahead. In July, Bloomberg and ISDA announced that Bloomberg Index Services Limited has begun calculating and publishing fallbacks that ISDA intends to implement for certain key IBORs, including adjusted RFRs (compounded in arrears), spread adjustments and "all in" IBOR fallback rates for various tenors of the Australian dollar Bank Bill Swap Rate (BBSW), the Canadian Dollar Offered Rate (CDOR), Swiss franc LIBOR, EURIBOR, Euro LIBOR, Sterling LIBOR, HIBOR, Euroyen TIBOR, Yen LIBOR, TIBOR and USD LIBOR. In addition, the ISDA board of directors and ARRC chairman Tom Wipf have issued statements advocating for adherence to the forthcoming ISDA protocol, and the FCA has spoken out in favor of adherence as well.

In September, the ARRC published two RFPs. One RFP seeks "one or more firms to publish daily indicative spreads and, after a trigger event has occurred, static spreads and spread-adjusted fallback rates [based on SOFR] for cash products that transition away from U.S. dollar (USD) LIBOR." The spreads and rates would be used in legacy contracts with the ARRC's recommended hardwired fallback language and other instances where spread-adjusted replacement rates are needed. The other RFP is for "a potential administrator to publish forward-looking Secured Overnight Financing Rate (SOFR) term rates," and notes that "[t]he RFP does not constitute a guarantee that any SOFR term rate or administrator will ultimately be recommended by the ARRC." Interestingly, the second RFP notes that creation of SOFR term rates is the final step in the ARRC's Paced Transition Plan, which it first announced in its March 2018 Second Report, in which the ARRC first recommended SOFR as the preferred replacement rate for LIBOR.

On the consumer side, in late May, Fannie Mae and Freddie Mac launched new LIBOR-transition websites (links are in the linked press release) and published the GSEs' "LIBOR Transition Playbook." In June, the Consumer Financial Protection Bureau launched a consumer-focused push to smooth the way toward LIBOR transition. The CFPB released an updated version of its Consumer Handbook on Adjustable Rate Mortgages (CHARM) to help consumers better understand adjustable rate mortgage loan products. It also released a Notice of Proposed Rulemaking concerning the anticipated discontinuation of LIBOR, including proposing examples of replacement indices that meet Regulation Z standards, and also some FAQs on LIBOR transition topics. In August, the ARRC published transition resource guides for LIBOR-based adjustable rate mortgages and legacy LIBOR- based private student loans.

The ARRC recommended that dealers reach out to their swaptions counterparties by June 30, 2020 to amend those transactions to move from EFFR discounting to SOFR discounting and agree upon "a voluntary, portfolio-level payment of compensation" to account for the value transfer that will result from that change. Three months later, a further announcement by the ARRC indicated that – unsurprisingly – its call for a "voluntary payment of compensation" had gone largely unheeded. In order "to avoid an extended period of

uncertainty and preempt potential disputes," the ARRC amended its recommendation to state that, "if counterparties cannot reach an agreement on the exchange of compensation before October 16, 2020, [the planned date of the switchover by the CME and LCH from Fed Funds to SOFR discounting] … then the counterparties should amend their legacy swaptions to bring them into scope for ISDA's Supplement 64 and specify an Agreed Discount Rate consistent with the swaptions' existing contractual terms."

A variety of surveys have attempted to gauge how well market participants' LIBOR transition work is progressing. In July, the Investment Association, which represents the investment management industry in the UK, published a report showing that UK investment managers have made significant progress in moving from LIBOR to SONIA, although progress on the transition to SOFR or other USD replacement rates was not covered. In August, the Financial Industry Regulatory Authority published the results of a survey of its member broker-dealers, which showed mixed progress, noting that, "while some large firms, notably large brokers-dealers affiliated with bank holding companies, had implemented extensive programs to prepare for the phase-out, others had made only limited efforts." In addition, KPMG and Numerix recently published results of their own surveys, both of which show a significant – and alarming – lack of preparation. In September, FT Alphaville published a comprehensive article about the state of LIBOR transition generally, concluding that the transition stands to disadvantage small businesses.

3. LIBOR transition has finally emerged as a supervisory and, potentially, enforcement issue in the US.

In July 2019, the US Securities and Exchange Commission issued a staff statement expressing concern about the potential impact of and risks associated with the expected discontinuation of LIBOR for the financial markets and certain market participants, including public companies, investment advisers, investment companies, and broker-dealers, and announcing that the SEC Staff "is actively monitoring the extent to which market participants are identifying and addressing these risks." (For more on the 2019 staff statement, see this article.) Consistent with the 2019 staff statement as well as the SEC's announced examination priorities for 2020, in June 2020, the Office of Compliance Inspections and Examinations announced an examination initiative or "sweep" regarding LIBOR transition preparedness. (For more on the SEC sweep, see this article.)

In July, the Federal Financial Institutions Examination Council – made up of leaders from the Federal Reserve Board of Governors, the CFPB, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Comptroller of the Currency, and the State Liaison Committee – issued a statement highlighting the financial, legal, operational, and consumer protection risks that will result from the expected discontinuation of LIBOR and encouraging supervised institutions to continue their efforts to prepare for this change and address those risks. The FFIEC statement also announced an increased supervisory focus on evaluating LIBOR transition preparedness during 2020-2021, and listed topics that will be discussed by supervisory staff during regularly scheduled examinations and monitoring activities.

4. Use of SOFR, the ARRC's recommended replacement rate, continues to grow modestly, but also continues to meet resistance from some market participants. Additional alternatives to SOFR are beginning to emerge and gain traction.

The slow – and, since the pandemic struck, flat – pace of SOFR adoption continues to be a concern. In July, ISDA launched the RFR Adoption Indicator, which monitors adoption of alternative risk-free rates in derivatives trading. So far, it shows adoption is relatively flat at best. (The monthly report is available on the ISDA website under "Research Notes.")

In May, the US Treasury requested comments on the possibility of issuing a SOFR-indexed floating rate note, and 21 sets of comments were submitted in July. The comments generally were in favor, and we understand that any such issuance is expected to come in 2021 at the soonest.

It is becoming increasingly clear that there is no one-size-fits-all replacement for LIBOR and that many market participants simply do not want to use a risk-free rate like SOFR. Perhaps responding to pressure from smaller banks that find SOFR unsuitable to their needs, in May, the ARRC stated its openness to "any active benchmark — not just the Secured Overnight Financing Rate — as an alternative if the rate is robust and complies with international principles." Shortly thereafter, Federal Reserve Board Chairman Jerome Powell, in response to a "question for the record" from Senator Tom Cotton following Powell's testimony before the US

Senate Committee on Banking, Housing and Urban Affairs in February 2020, issued a written statement regarding the suitability of AMERIBOR as a replacement to LIBOR, which concluded that, "While [Ameribor] is a fully appropriate rate for the banks that fund themselves through the American Financial Exchange (AFX) or for other similar institutions for whom Ameribor may reflect their cost of funding, it may not be a natural fit for many market participants."

AMERIBOR and the ICE Bank Yield Index continue to lead the headlines as perhaps the most viable potential alternatives to SOFR as a replacement for LIBOR. During the summer, the Bloomberg Odd Lots podcast featured a multi-part series on LIBOR in June, including an interview with Richard Sandor, the creator of AMERIBOR. Meanwhile, former CFTC chair Christopher Giancarlo – who sits on the board of AMERIBOR's creator, the American Financial Exchange – has been extremely vocal in favor of the small-bank benchmark.

Other new potential SOFR alternatives have surfaced over the summer. IHS Markit announced (subscription only) it is working on a dynamic credit spread based on data such as credit default swap and bond prices that could be used with SOFR for USD loans. Meanwhile, Tradeweb and ICE have announced they are working on a SOFR alternative in the form of a daily Treasury yield curve based on transactions on Tradeweb's institutional trading platform, among the biggest marketplaces for US government debt. The curve includes 12 tenors ranging from one month to 30 years, and began publication in July.

In August, Risk.net (subscription only) discussed another issue hampering SOFR adoption: there currently are varying conventions for calculating SOFR-based interest payments. The Loan Syndications and Trading Association published a response, disagreeing with the somewhat inflammatory headline on the Risk.net article.

5. "Tough legacy" transactions continue to be a paramount concern as LIBOR transition approaches. Various potential mitigants have been proposed, but none qualifies as a "solution" – to the contrary, the proposals to date generate additional uncertainties of their own.

So-called "tough legacy" transactions, which have no or inadequate LIBOR fallback language and cannot readily be amended, pose a significant financial stability risk, and true solutions are lacking – and are unlikely to be forthcoming. As Friedman Kaplan's Anne Beaumont told Risk.net (subscription only) in July, "The whole ballgame here is tough legacy and there's no simple solution for it." That same month, the UK FCA's Latter reminded participants in an international webinar of the importance of shrinking their legacy books of LIBOR-linked contracts, noting that market participants should not expect regulators to ride to the rescue:

In short, if you rely on regulatory action you will have neither certainty nor control, and you may not get what you want. The only way for contractual counterparties to have that certainty and control over the future of their obligations is to convert them by mutual agreement. […] And the smaller your legacy books, the smoother the journey through the end-game will be.

Nonetheless, three different potential legislative approaches are now in play in three different jurisdictions:

- In the US, the ARRC floated language in March – just as the pandemic hit the US – for legislation that could be enacted by the New York State Legislature. That proposal has yet to make its way onto the Legislature's agenda, and it is not expected to do so before the end of 2020.

- At the end of May, the Tough Legacy Taskforce of the Working Group on Sterling Risk-Free Reference Rates published its conclusion that "there is a case for action to consider what can be done to address tough legacy LIBOR exposures in the UK." Since then, the UK Government has announced its intention to "legislate to amend and strengthen that existing regulatory framework, rather than directly to impose legal changes on LIBOR-referencing contracts that are governed by UK law." The UK Financial Conduct Authority also announced that in due course it will "publish statements of policy on its approach to potential use of these powers following further engagement with stakeholders in the UK and internationally." These announcements (made on the same day) show that the UK's approach will be to facilitate some sort of synthetic LIBOR rather than attempting to amend tough legacy contracts wholesale through legislation, as the ARRC has proposed in the US.

- In July, the European Commission weighed in with a proposal to amend the Benchmark Regulation "to establish a statutory replacement rate that mitigates the adverse consequences for legal certainty and financial stability that might ensue if LIBOR, or any other benchmark whose cessation would result in significant disruption in the functioning of financial markets in the Union, was discontinued without such a replacement rate being both available and integrated into legacy contracts that involve a supervised entity within the scope of the BMR." The EC amendment would apply to "All contracts referencing a benchmark in cessation that involve an EU supervised entity as a counterpart." The proposal does not say what the "statutory replacement rate" would be.

These three proposals create a variety of difficulties of their own, which are discussed in detail in a recent joint (and transatlantic) article co-authored by Anne Beaumont of Friedman Kaplan's LIBOR Transition Task Force and Audrey Favreau and Janine Alexander of UK law firm Collyer Bristow.

In other work by the Friedman Kaplan LIBOR Transition Task Force, the firm collaborated with Eigen Technologies to analyze LIBOR fallback provisions in hundreds of credit agreements to see how effectively they integrated ARRC-recommended LIBOR fallback provisions into agreements containing a "cost-of-funding" out for the lender. The results of their analysis are available here. Among other things, the survey showed that only in a small minority of agreements do parties successfully implement the ARRC-recommended fallback provisions without creating a potential conflict with other provisions in the agreement.

Finally, as in our prior LinkWraps, we check in on the quarterly Citibank Fixed Income Conference Call to see if Citi has come up with a solution to address the problematic LIBOR fallback language in some of its permanent preferreds, which *Barron's* first identified in January 2019. The answer as of the end of Q2? Still no.

How Friedman Kaplan Can Help

Friedman Kaplan's LIBOR Transition Task Force is ready to:

- Help clients understand the legal, compliance, business and operations implications of LIBOR transition and develop strategies to address LIBOR-related exposures in advance of the 12/31/21 deadline

- Help clients identify possible "friction" points and areas of dispute in legacy LIBOR- linked transactions and develop mitigation strategies, where possible, and litigate claims and disputes, where necessary

- Advise clients in connection with new and existing credit, lending and other business agreements referencing LIBOR to ensure they include appropriate provisions, including LIBOR fallbacks, and to amend other provisions so fallbacks work seamlessly

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