July 7, 2020

LIBOR Transition Update: Efforts Continue to Transition from LIBOR to Alternative Reference Rates by the End of 2021

Notwithstanding the impact of COVID-19 on the global economy and market participants, from the perspective of regulators, working groups and industry leaders, the anticipated cessation of the London Interbank Offered Rate ("LIBOR") remains the end of calendar year 2021.[1] Indeed, the UK Financial Conduct Authority ("FCA") has confirmed this 2021 deadline.[2] The Bank of England ("BoE") has explained that that the global market volatility caused by COVID-19 highlights the need to shift away from LIBOR, pointing out that LIBOR rates rose as central bank policy rates fell, reflecting low activity for the LIBOR market.[3]

While the worldwide pandemic has delayed certain interim deadlines and has increased challenges faced by market participants as they work to implement proposed alternative reference rates, international and U.S. regulators, industry leaders and working groups have maintained their focus on an efficient LIBOR transition. We provide an overview of developments and regulatory guidance issued during the first half of 2020, all of which reaffirm the critical importance of being prepared for the cessation of LIBOR as a reference rate, which affects an estimated $200 trillion of financial instruments referencing U.S. Dollar LIBOR.[4]

Developments Impacting the LIBOR Transition Timeline

Over the past few months, the efforts of the global marketplace to smoothly transition from LIBOR to alternative reference rates has faced unprecedented challenges arising from the COVID-19 pandemic and the resulting economic upheaval.

1 *See* Paul, Weiss March 30, 2020 Client Memorandum, *COVID-19: LIBOR 2021 Cessation Timing Unchanged Though Planning Delays Expected*, *available* here.

2 FCA's national and international response to coronavirus (COVID-19) and Brexit, Speech delivered by Nausicaa Delfas, Executive Director of International, at Deloitte Annual Conduct Risk Conference, FCA, June 5, 2020, *available* here.

3 *Interim Financial Stability Report*, BoE, May 2020, *available* here.

4 *Transition from LIBOR*, Alternative Reference Rates Committee ("ARRC"), *available* here.

United States:

The Fed Pivots Away from SOFR to LIBOR for Its Main Street Lending Program Due to Pressure From Market Participants

On April 9, 2020, the Federal Reserve Bank (the "Fed") announced that it intended to issue loans referencing the Secured Overnight Financing Rate ("SOFR")[5] for its Federal Main Street Lending Program (the "Main Street Program"),[6] under which the Fed would provide loans to small and medium-sized businesses to combat the financial impacts of the COVID-19 pandemic. Three weeks later, on April 30, the Fed reversed its position and announced that it would use LIBOR instead of SOFR as the benchmark rate for approximately $75 billion in loans issued under the Main Street Program.[7] The Fed's pivot from SOFR to LIBOR apparently resulted from resistance from potential participants in the Main Street Program, who complained that implementing new systems to issue SOFR-linked loans for the Main Street Program would divert additional resources from existing challenges arising from COVID-19. In selecting LIBOR, the Fed acknowledged the impact of its decision on the LIBOR transition by stating, "LIBOR remains the most common base rate used in business lending, even though firms cannot rely on LIBOR being published after the end of 2021."[8]

As a practical matter, the Fed's reversal will create a large volume of new LIBOR-linked loans with less than two years until the stated LIBOR transition deadline. This likely will lead to a wave of renegotiation and valuation challenges, as well as litigation risks with the anticipated cessation of LIBOR's publication looming. Critically, the Fed's decision tacitly acknowledges that market participants and the U.S. economy are not ready for a switch from LIBOR to alternative reference rates, a revelation that could ultimately hamper market-wide transition to SOFR over the coming months. Nevertheless, by cautioning lenders and borrowers to include fallback contract language to SOFR for loans that extend beyond the start of 2022, the Fed also signaled, from its perspective, the 2021 deadline is unlikely to change.

5 SOFR is the Federal Reserve Bank of New York's endorsed benchmark rate that best represents for U.S. Dollar LIBOR derivative and other financial contract instruments. The ARRC is a group of private-market participants convened by the Fed and the Federal Reserve Bank of New York to help ensure a successful transition from U.S. Dollar LIBOR.

6 *Main Street Lending Program*, *FAQ*, Federal Reserve Bank, *available* here; Vipal Monga and Cezary Podkul, *Fed Won't Use Stimulus Aid to Push Libor Replacement*, WSJ, May 3, 2020, *available* here [Subscription Required].

7 *Federal Reserve Board announces it is expanding the scope and eligibility for the Main Street Lending Program*, Federal Reserve Bank, Apr. 30, 2020, *available* here.

8 *Main Street Lending Program*, *FAQ*, Federal Reserve Bank, *available* here.

The ARRC's Proposed New York State Legislation for SOFR Implementation Remains Unaddressed

In our March 2020 client memorandum, we noted that the legislative solution announced by the ARRC might not be timely considered by the New York State legislature as a result of the COVID-19 pandemic.[9] The ARRC's proposed legislation aims to encourage widespread adoption of SOFR for U.S. Dollar LIBOR instruments by:

- prohibiting a party from refusing to perform its contractual obligations or declaring a breach of contract as a result of the discontinuance of LIBOR or the use of the statute's recommended benchmark replacement (SOFR);
- definitively establishing that the recommended benchmark replacement (SOFR) is a commercially reasonable substitute for, and a commercially substantial equivalent to, LIBOR; and
- providing a safe harbor from litigation for the use of the recommended benchmark replacement (SOFR).[10]

Because of the COVID-19 pandemic, the New York State Legislature has yet to address the ARRC's aforementioned proposal, and it is unclear when this measure will be addressed, and if it will be enacted.[11]

International

UK Regulators Extend Deadline for Ending Use of Sterling-linked LIBOR in New Loans

In the midst of the pandemic, on April 29, 2020, the FCA issued a statement in which it noted that it, the BoE and the Working Group on Sterling Risk-Free Reference Rates (the "RFRWG") had concluded that it will not be feasible to complete the transition away from LIBOR across all new sterling LIBOR-linked loans by the original end-Q3 2020 target and that there will likely be continued use of LIBOR-referencing loan products into Q4 2020.[12] In particular, the FCA and its counterparts recognized the need to maintain the

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9 *See* Paul, Weiss March 30, 2020 Client Memorandum, *COVID-19: LIBOR 2021 Cessation Timing Unchanged Though Planning Delays Expected*, *available* here.

10 Proposed Legislative Solution to Minimize Legal Uncertainty and Adverse Economic Impact Associated with LIBOR Transition, ARRC, *available* here.

11 Notwithstanding these legislative hurdles, the proposed legislation may also face certain challenges on the basis that it potentially conflicts with federal law, such as Section 316(b) of the Trust Indenture Act of 1939, and the U.S. Constitution, specifically Article I, Section 10, Clause 1 (Contracts Clause).

12 *Further statement from the RFRWG on the impact of Coronavirus on the timeline for firms' LIBOR transition plans*, FCA, Apr. 29, 2020 (hereinafter, "RFRWG Statement"), *available* here. In January 2020, UK regulators previously published 2020

smooth flow of credit to the real economy. In light of this, the RFRWG recommends the following revised deadlines:[13]

- by the end of Q3 2020, lenders should be in a position to offer non-LIBOR linked products to their customers;
- after the end of Q3 2020, lenders should include clear contractual arrangements, such as pre-agreed conversion terms or an agreed upon process for renegotiation, in all new and re-financed LIBOR-referencing loan products to facilitate conversion to SONIA[14] or other alternatives before 2022; and
- by the end of Q1 2021, lenders should stop issuing any new sterling LIBOR-referencing loan products that will expire after the end of 2021.

The FCA statement concluded by noting that the chair of the RFRWG, the FCA and the BoE will continue to work with members of the RFRWG and international counterparts to assess the evolving impact of COVID-19 on firms' LIBOR transition efforts, and provide further updates in due course.

UK Government Announces Intent to Provide FCA With Enhanced Regulatory Powers to Address LIBOR Transition

Despite the aforementioned extensions of certain interim deadlines set by UK regulators, the UK government recently announced a plan to broaden the FCA's powers in the forthcoming Financial Services Bill to address LIBOR transition.[15] The government notes that, unlike many other jurisdictions, the UK has an existing regulatory framework for critical benchmarks. Rather than impose legal changes on LIBOR-referencing contracts governed by UK law, the government intends to amend and strengthen the existing framework by the end of 2021 such that the FCA has the appropriate regulatory powers to manage and

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targets intended to support the transition by market participants away from LIBOR to the Sterling Overnight Index Average ("SONIA") rate by the end of 2021. One interim milestone called for banks to stop issuing new sterling-denominated loans using the LIBOR benchmark by the end of the third quarter of 2020. *See Next steps for LIBOR transition in 2020: the time to act is now*, *FCA*, Jan. 16, 2020, *available* here.

13 *RFRWG Statement*, FCA, Apr. 29, 2020, *available* here.

14 SONIA is the effective overnight interest rate paid by banks for unsecured transactions in the British sterling market. It is used for overnight funding for trades that occur in off-hours and represents the depth of overnight business in the marketplace. SONIA is the RFRWG's preferred benchmark for the transition to sterling risk-free rates from LIBOR.

15 Rishi Sunak, Chancellor of the Exchequer, *Financial Services Regulation: Written statement - HCWS307*, UK Parliament, June 23, 2020, *available* here; *FCA statement on planned amendments to the Benchmarks Regulation*, FCA, June 23, 2020, *available* here; *Benchmarks Regulation—Proposed New Powers*, FCA, June 23, 2020, *available* here.

direct the wind-down period prior to LIBOR cessation in order to protect consumers and ensure market integrity. The government therefore intends to:

- amend the UK's existing regulatory framework for benchmarks to ensure it can be used to manage different scenarios prior to a critical benchmark's eventual cessation;
- extend the circumstances in which the FCA may require an administrator to change the methodology of a critical benchmark and clarify the purpose for which the FCA may exercise this power. This would enable the FCA to direct a methodology change for a critical benchmark, in circumstances where it has found that the benchmark's representativeness will not be restored and where action is necessary to protect consumers and/or to ensure market integrity;
- strengthen existing law to prohibit use of an individual critical benchmark where its representativeness will not be restored, while giving the regulator the ability to specify limited continued use in legacy contracts; and
- refine ancillary areas of the UK's regulatory framework for benchmarks to ensure its effectiveness in managing the orderly wind down of a critical benchmark, including that administrators have adequate plans in place for such situations.

For its part, the FCA welcomed the announcement, emphasizing that the proposed enhanced powers could help solve the problem of "tough" legacy contacts. "Although this would not make the benchmark representative again, it would allow the FCA to stabilize certain LIBOR rates during a wind-down period so that limited use in legacy contracts could continue, if suitable robust inputs to support such a methodology change are available," the FCA stated.[16]

U.S. Regulators, Working Groups, and Industry Leaders Continue to Focus on Operational Strategies for a Smooth Transition Away From LIBOR

Notwithstanding the challenges facing a smooth transition away from LIBOR, domestic U.S. regulators, working groups and industry leaders have reaffirmed the 2021 cessation deadline and announced various efforts as part of an effective and efficient LIBOR transition for market participants in advance of the deadline.

16 *FCA statement on planned amendments to the Benchmarks Regulation*, FCA, June 23, 2020, *available* here.

Domestic U.S. Regulatory Activity:

As we outlined in January,[17] the New York Department of Financial Services ("DFS"), the Consumer Financial Protection Bureau ("CFPB"), the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA"), and Office of the Comptroller of the Currency ("OCC") have followed the lead of the Fed and the Federal Reserve Bank of New York in emphasizing to their regulated entities the necessity of LIBOR transition preparation. In particular:

- *The CFPB* recently released a Notice of Proposed Rulemaking (the "NPRM") concerning the anticipated cessation of LIBOR, an updated Consumer Handbook on Adjustable-Rate Mortgages ("CHARM") and guidance in the form of frequently asked questions on transition topics. Under the NPRM, the CFPB would amend the Truth In Lending Act's Regulation Z.[18] The NPRM also proposes examples of replacement indices for LIBOR for open-end and closed-end products that meet Regulation Z standards and would permit creditors of home equity lines of credit and credit card issuers to replace LIBOR with alternative reference rates such as SOFR on or after March 15, 2021, if certain conditions are met. Comments on the NPRM are due by August 4, 2020.[19]

- *DFS* maintained its March 23, 2020 deadline, seeking assurances from its regulated institutions' board of directors (or similar governing authorities) and senior management that they have assessed LIBOR transition risks.

- *The SEC's Office of Compliance Inspections and Examinations ("OCIE")* identified registrant preparedness for the transition away from LIBOR as an examination program priority for FY 2020.[20] Last month, OCIE issued a Risk Alert that provides registrants with additional information about the scope and content of SEC examinations that will focus on registrants' efforts to prepare for the expected discontinuation of LIBOR and their transition to alternative reference rates, and emphasized that LIBOR transition may present a material risk for these entities. OCIE stated that it will review registrants' plans regarding:

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17 *See* Paul, Weiss January 29, 2020 Client Memorandum, *Global Regulators Press Market Participants to Prepare Now for LIBOR Transition*, *available* here.

18 Regulation Z principally prohibits specific acts and practices in connection with an extension of credit secured by a consumer's dwelling (*i.e.*, certain practices relating to payments made to compensate mortgage brokers and other loan originators).

19 *Fast Facts: Proposed LIBOR Transition Rule*, CFPB, *available* here.

20 *Examination Initiative: LIBOR Transition Preparedness*, SEC, June 18, 2020, *available* here. "Registrant" includes SEC-registered investment advisers, broker-dealers, investment companies, municipal advisors, transfer agents and clearing agencies.

- the registrant's and investors' exposure to LIBOR-linked contracts that extend past the current expected discontinuation date, including any fallback language incorporated into these contracts;

- the registrant's operational readiness, including any enhancements or modifications to systems, controls, processes, and risk or valuation models associated with the transition to a new reference rate or benchmark;

- the registrant's disclosures, representations, and/or reporting to investors regarding its efforts to address LIBOR discontinuation and the adoption of alternative reference rates;

- identifying and addressing any potential conflicts of interest associated with the LIBOR discontinuation and the adoption of alternative reference rates; and

- clients' efforts to replace LIBOR with an appropriate alternative reference rate.

- *FINRA* reiterated that it will engage with market participants outside of its examination program to understand how the industry is preparing for the LIBOR transition. FINRA will focus on market participants' exposure to LIBOR-linked financial products; steps that market participants are taking to plan for the transition away from LIBOR to alternative rates, such as SOFR; and the impact of the LIBOR phase-out on customers.[21]

- *The OCC* continues to direct market participants to focus on and appropriately execute their LIBOR transition processes before the 2021 cessation deadline. On July 1, 2020, the OCC issued a bulletin highlighting the Federal Financial Institution Examination Council's ("FFIEC") statement regarding LIBOR transition and added further guidance to that of the FFIEC.[22] Additionally, late last month, the OCC, along with the Fed, the Federal Deposit Insurance Corporation ("FDIC"), the Federal Housing Finance Agency ("FHFA") and the Farm Credit Administration, finalized changes to its swap margin rule to help ensure a smooth transition away from LIBOR to alternative reference rates, such as

21 *2020 Risk Monitoring and Examination Priorities Letter*, FINRA, Jan. 9, 2020, *available* here.

22 *Libor Transition: FFIEC Statement on Managing the Libor Transition and Guidance for Banks*, OCC, July 1, 2020, *available* here.

SOFR. The final rule[23] allows swap entities to amend legacy swaps to replace the reference to LIBOR or other reference rates that are expected to end without triggering margin exchange requirements.[24]

Working Groups and Industry Leaders

The ARRC and the International Swaps and Derivatives Association ("ISDA"), among others, have been active in preparing and releasing LIBOR transition guidance for market participants. These groups have been at the forefront of fielding and addressing constituent concerns to ensure minimal market disruption as market participants transition to SOFR.

Their efforts continue to spur change. For example, trading in SOFR-linked U.S. Dollar instruments has rapidly increased in recent months, indicating that some market sectors have embraced a post-LIBOR environment. Some of these SOFR-related increases have been the direct result of the COVID-19 induced market volatility, such as sales of U.S. agency debt linked to SOFR, which dramatically increased in March both in terms of volume and in comparison to the use of U.S Dollar LIBOR. In fact, 98% of the total bond issuances during this period was benchmarked to SOFR, a more than 100% increase over the same period from 2019.[25]

The ARRC

- *Key Objectives for 2020*: The ARRC identified six key objectives for 2020, which aim to achieve market readiness for LIBOR transition and to support market acceptance of SOFR as a viable alternative for U.S. Dollar LIBOR instruments.[26] For each objective, the ARRC provided milestone dates for completion. These objectives include:
  - supporting SOFR's use and liquidity by addressing concerns related to a forward-looking term SOFR rate by *September 30, 2020*, establishing final recommended conventions for SOFR-based floating rate notes, business loans, and securitizations by *July 31, 2020*, and continuing to explore potential methods to facilitate the movement of legacy derivative positions from LIBOR to SOFR;

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23 Final Rule Margin and Capital Requirements for Covered Swap Entities, 12 CFR Part 45, Docket No. OCC-2019-0023, RIN: 1557-AE69, OCC, June 25, 2020, *available* here.

24 *Agencies Finalize Amendments to Swap Margin Rule*, OCC, June 25, 2020, *available* here (noting that the final rule also clarifies that swap entities may conduct risk-reducing portfolio compression or make certain other non-substantive amendments to their legacy swap portfolios without altering their legacy status).

25 Christopher Maloney, *Issuance of SOFR-Linked U.S. Agency Debt Skyrocketed in March*, Bloomberg, Apr. 8, 2020, *available* here [Subscription Required].

26 *2020 Objectives*, ARRC, *available* here.

- continuing to encourage the development and strengthening of market infrastructure and operations to support SOFR by creating tools that aid market participants in maximizing internal efficiencies;

- creating and encouraging the use of robust contractual fallbacks by finalizing technical details related to recommended spread adjustments by *September 30, 2020*, and through publishing final recommendations for hardwired fallback language by *June 30, 2020*;[27]

- publishing recommended fallback language for certain consumer products by *June 30, 2020*, and developing materials to support consumer education and outreach efforts regarding the transition by *September 30, 2020*;

- continuing to increase clarity on key legal, tax, accounting, and regulatory matters for market participants; and

- continuing to advance outreach, education, and global coordination in promoting the broad and comprehensive benefits as well as the technical details surrounding the LIBOR transition.

- *Best Practices for Transitioning From LIBOR to SOFR*:[28] The ARRC published recommended best practices intended to assist market participants and clarify LIBOR transition timelines and interim milestones that will minimize market disruption and support a smooth transition through the broad adoption of SOFR. For example, the ARRC recommends that:

  - to the extent not already utilized, new U.S. Dollar LIBOR cash products should include the ARRC-recommended (or substantially similar) fallback language as soon as commercially possible;

  - third-party technology and operations vendors supporting market participants in the transition should complete all necessary enhancements to support SOFR by the end of 2020;

  - new U.S. Dollar LIBOR product issuances should stop as soon as commercially possible (*e.g.*, market participants should stop issuing leveraged loans tied to LIBOR by the end of June 2021); and

  - for contracts specifying that a party will select a replacement rate at their discretion following a LIBOR-transition event (*i.e.*, when LIBOR is not representative of the underlying market), the

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27 The ARRC met its deadline of June 30 for issuing a final recommendation for hardwired fallback language involving syndicated loans.

28 *ARRC Recommended Best Practices for Completing the Transition from LIBOR*, ARRC, *available* here.

determining party should disclose its planned selection to involved parties at least six months prior to the date when a replacement rate would become effective.

- *Recommended Spread Adjustment Methodology for Cash Products*:[29] As we previously highlighted,[30] following its April 7, 2020 meeting, the ARRC announced that its recommended spread adjustment methodology would be based on a historical median over a five-year lookback period, calculating the difference between U.S. Dollar LIBOR and SOFR. The result was based on market participant feedback to the ARRC's January 2020 consultation on the topic. This methodology aligned with ISDA's recommended methodology for derivatives and would have made the ARRC's recommended spread-adjusted version of SOFR comparable to U.S. Dollar LIBOR.
  - Nevertheless, in May, the ARRC considered another potential option for calculating the five-year median spread that had not been included in its January consultation. Specifically, the ARRC invited participants to consider the option to use ISDA's spread adjustment values across all of the different fallback rates, rather than using the same adjustment methodology to calculate a different spread adjustment for each potential fallback rate. Additionally, the ARRC's supplemental consultation sought views on whether the timing of the calculation of the ARRC's spread adjustment should match ISDA's timing if a pre-cessation event is operative (*i.e.*, should LIBOR not reflect the underlying market prior to its cessation).[31]
  - On June 30, the ARRC released the results to its supplemental consultation and noted that a clear majority of respondents favored a recommendation of the same spread adjustment values as ISDA and respondents unanimously preferred that the timing of the ARRC recommendation on spread adjustments align with timing of the ISDA spread adjustment.[32]

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29 *ARRC Announces Recommendation of a Spread Adjustment Methodology for Cash Products*, ARRC, Apr. 8, 2020, *available* here; *ARRC Issues Supplemental Consultation on Spread Adjustment Methodology*, ARRC, May 6, 2020, *available* here.

30 *See* Paul, Weiss April 9, 2020 Client Memorandum, *LIBOR Cessation: ARRC Announces Recommendation for Spread Adjustment Methodology for Cash Products*, *available* here.

31 The supplemental consultation was open for feedback through June 8, 2020. In addition, the ARRC's Floating Rate Notes Working Group issued a technical statement on how market participants may reference the New York Fed's published SOFR Index in Floating Rate Note (FRNs). *See ARRC Floating Rate Notes Working Group Statement On Use Of The SOFR Index*, ARRC, *available* here. According to the statement, the SOFR Index could be used to simplify documentation, reduce operational risk and streamline system development by allowing market participants to more easily calculate and reconcile payment amounts. *Id.*

32 Several respondents generally cited the importance of consistency with ISDA values from a hedging perspective. *ARRC Announces Further Details Regarding Its Recommendation of Spread Adjustments for Cash Products*, ARRC, June 30, 2020, *available* here. The ARRC received 49 responses to its supplemental consultation from a mix of banks, government-sponsored

- Following this feedback, the ARRC determined that it will implement its spread methodology recommendations, as follows:
- For cash products other than consumer products, the ARRC's recommended spread adjustment will match the value of ISDA's spread adjustments to U.S. Dollar LIBOR. Given the special considerations for consumer products and that the ARRC will include a one-year transition period as part of its recommended spread adjustments for consumer products, the ARRC is further considering its customized approach for these specific products,
- For all cash products, in the event that a pre-cessation event occurs, the ARRC's recommended five-year historical median spread adjustments will be determined at the same time as the ISDA's spread adjustments, which will be at the time of any announcement that LIBOR will or has ceased or will or has become no longer representative.

- *Recommended Hardwired Fallback Language for Syndicated Loans*:[33] On June 30, the ARRC issued updated hardwired fallback language, which now recommends the use of a simple daily SOFR in arrears and includes a more permissive early opt-in trigger, which would allow parties to syndicated loans to switch over to an alternative reference rate such as SOFR before the hard end-of-2021 deadline. The ARRC initially released recommended fallback language for syndicated loans in April 2019.

ISDA

- *Report on Final Consultation on How to Implement Pre-Cessation Fallbacks in Derivatives*:[34] On May 14, ISDA published a report that summarized the final results of its consultation on the implementation of pre-cessation fallbacks for derivatives referencing LIBOR. The consultation, which was launched in February, was met with a resounding "yes" from market participants, which were asked whether the 2006 ISDA Definitions should be amended to include fallbacks that would apply to all covered derivatives referencing LIBOR instruments following a permanent cessation of the benchmark or a "non-representative" pre-cessation event, whichever should occur first. Moving ahead, ISDA expects to publish amendments to the 2006 ISDA Definition to incorporate the fallbacks for new trades in July.

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entities, asset managers, insurance companies, and industry associations. Responses were broadly similar across these industry types.

33 *ARRC Releases Updated Recommended Fallback Language for Syndicated Loans*, ARRC, June 30, 2020, *available* here.

34 *Summary of Responses to the ISDA 2020 Consultation on How to Implement Pre-Cessation Fallbacks in Derivatives*, ISDA, May 14, 2020, *available* here. We previously reported on the preliminary results of this consultation in April. *See* Paul, Weiss April 20, 2020 Client Memorandum, *LIBOR Cessation: ISDA Announces Preliminary Results of Consultation on Pre-cessation Fallbacks for LIBOR*, *available* here.

Simultaneously, ISDA will launch a protocol to enable participants to incorporate such revisions into legacy trades if they so choose.

The Credit Sensitivity Working Group ("CSG")

- In February, the Fed, the OCC, and the FDIC launched a Credit Sensitivity Working Group ("CSG") to address the challenges raised by regional banks in fall 2019 regarding operational hazards related to their impending implementation of SOFR.[35] Regional banks had voiced their concerns to regulators about the potentially adverse impact that a move from U.S. Dollar LIBOR to a standalone SOFR could create on their ability to manage their balance sheets in times of economic stress. For instance, the regional banks claimed that the difference between SOFR and LIBOR could cause the return on their SOFR-linked loans to decline as their unhedged cost of funds increased.[36]

- Consequently, the CSG's initial meeting in February focused on its primary objectives of "build[ing] a shared understanding of the challenges of US regional CSG's community banks in shifting to SOFR" and "support[ing] resilience in times of stress."[37] The CSG also discussed potential approaches to the challenges raised by the regional banks, including "credit-sensitive rate/spread that could be added to SOFR."[38] Since its inaugural meeting, the CSG has met only one other time, last month, and has yet to issue any guidance or solutions to address these SOFR-related concerns. As a result, observers have noted that this delay has pushed the CSG to "race[] against time to develop a credit spread methodology that will satisfy recalcitrant lenders."[39]

Conclusion

Given recent global crises, the transition away from LIBOR may not be top of mind for market participants, executives, and boards of directors. But legislators, regulators, industry leaders, and working groups continue to emphasize the end-of-2021 cessation deadline and the need to focus on transition planning.

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35 *Meeting with Regional Bank Signatories to Discuss Credit Sensitivity Workshops*, New York Federal Reserve Bank, Feb. 25, 2020, *available* here; *Transition from LIBOR: Credit Sensitivity Group Workshops*, New York Federal Reserve Bank, June 4, 2020, *available* here; Marcus Burnett, *How regional banks could shape US Libor replacement*, Risk.Net, Apr. 21, 2020, *available* here [Subscription Required].

36 Marcus Burnett, *How regional banks could shape US Libor replacement*, Risk.Net, Apr. 21, 2020, *available* here [Subscription Required].

37 *Id.*

38 *Id.*

39 *Id.*

They also expect that market participants will be adequately prepared to transition notwithstanding that some interim deadlines have been delayed.

Indeed, the volume of LIBOR-linked instruments is so great that there may be substantial legal, business and regulatory risks for those who adopt a "wait-and-see" approach with the hope that the cessation deadline will be extended. As a result, market participants should prioritize and devote necessary resources to LIBOR transition. Senior management should consider instituting more frequent oversight of LIBOR-transition processes, including assessments of whether risk disclosures are sufficient, reviewing LIBOR transition impacts on balance sheets, receiving regular updates on the progress of LIBOR-related negotiations, and discussions with counterparties and customers. Boards of directors should also consider as part of their risk oversight functions receiving updates from management on these efforts.

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