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Global Regulators Press Market Participants to Prepare Now for LIBOR Transition

It is widely expected that within two years, by the end of 2021, the London Interbank Offered Rate (“LIBOR”) will no longer be published by LIBOR panel banks. Recognizing the potential impact LIBOR’s cessation could have on lenders, borrowers and other market participants, global regulators are now urging all market participants to give immediate attention to the transition away from LIBOR. Last week, the UK Financial Conduct Authority (“FCA”), the Bank of England (“BoE”) and the Working Group on Sterling Risk-Free Reference Rates or “RFRWG” (the equivalent of the U.S. Alternative Reference Rates Committee) issued a set of documents to accelerate the transition away from LIBOR. The publication of these documents followed reports late last year noting the lack of progress in various areas, particularly the lending and securitization market.¹

These recent calls to action follow several recent pronouncements by global regulators of the importance of LIBOR transition preparation. For example, last week, the deputy chief executive of the Hong Kong Monetary Authority called on Hong Kong’s banks to improve their LIBOR transition efforts. And last month, the Office of the Comptroller of the Currency (“OCC”) and the New York Department of Financial Services (“DFS”) each announced increased oversight of LIBOR transition planning, with the OCC highlighting that it will examine banks on whether they have begun to assess their exposure to LIBOR, and the DFS requiring regulated institutions to submit LIBOR transition plans by February 7, 2020. On December 30, 2019, the U.S. Securities and Exchange Commission (“SEC”) encouraged audit committees of SEC reporting companies to exercise diligence in overseeing their companies’ LIBOR preparedness. On January 9, 2020, the Financial Industry Regulatory Authority (“FINRA”) announced plans to engage with firms on LIBOR transition outside its examination program. The Consumer Financial Protection Bureau (“CFPB”) has also provided guidance on its blog, noting that the expected discontinuance of LIBOR could affect various consumer financial products. Consistent with the foregoing, the Financial Stability Board issued a report on December 18, 2019 encouraging the use of overnight risk-free rates across global interest rate markets and warning that “regulated firms should expect increasing scrutiny of their transition efforts as the end of 2021 approaches.”²

As we discuss below, these recent developments demonstrate regulators’ continued focus on companies’ LIBOR transition readiness and provide certain concrete steps that can be taken in the near-term to mitigate risks.

U.K. Regulators Encourage Transition to Sterling Overnight Index Average (“SONIA”) Along with Other Measures

On January 16, 2020, the BoE and FCA, along with the RFRWG, issued various documents outlining priorities and milestones for LIBOR transition.³

The RFRWG published its priorities and an updated roadmap for 2020, in its words, “to highlight important events and clarify actions market participants should take to reduce LIBOR exposure and transition to alternative rates,” including:

- ceasing issuance of cash products linked to sterling LIBOR by the end of Q3 2020;
- taking steps that demonstrate that the compounded SONIA is easily accessible and usable;
- enabling a further shift of volumes from LIBOR to SONIA in derivatives markets, supported by a statement from the BoE and FCA encouraging a switch in the convention for sterling interest rate swaps from March 2, 2020 onwards;
- establishing a framework for the transition of legacy LIBOR products, in order to significantly reduce the stock of LIBOR referencing contracts by Q1 2021; and
- considering how best to address issues in “tough legacy” contracts.⁴

The RFRWG also published a series of separate documents, including:

- a document setting out its views on which types of businesses and clients should use SONIA, as compared to alternatives, including forward-looking term rates;
- a set of “lessons learned” from recent conversions of legacy LIBOR contracts; and
- a fact sheet explaining why market participants need to act now.

Concurrently, the FCA and the BoE (each ex-officio members of the RFRWG) published two additional documents, including:

- a joint letter sent to banks and insurers that are supervised by UK regulators, which sets out the initial expectations of the FCA and the Prudential Regulatory Authority concerning the LIBOR transition timeline; and
- a statement from the FCA and the BoE encouraging market makers to change the convention for sterling interest rate swaps from LIBOR to SONIA by March 2, 2020 — a change intended to further reduce risks associated with LIBOR cessation.⁵

The UK authorities specifically highlight the risks inherent in entering into new LIBOR transactions, particularly those maturing after the anticipated 2021 cessation date for LIBOR, and encouraged market participants to take appropriate steps to ensure that they and any affected clients are aware of these risks as well. The joint letter’s warning is emphatic and unambiguous: “*The intention is that sterling LIBOR will cease to exist after the end of 2021. No firm should plan otherwise.*”⁶

New York's DFS Requires Submission on LIBOR Transition

On December 23, 2019, Linda Lacewell, the Superintendent of the DFS, issued an industry-wide letter to DFS-regulated institutions identifying risks arising from the cessation of, and transition from, LIBOR.⁷ Given the significant risks associated with LIBOR's termination, DFS issued its letter to seek assurances from its regulated institutions' boards of directors (or similar governing authorities) and senior management that they have assessed LIBOR transition risks.

DFS requested that institutions submit responses by February 7, 2020, describing: (1) programs that would identify, measure, monitor and manage all financial and non-financial risks of transition; (2) processes for analyzing and assessing alternative rates, and the potential associated benefits and risks of such rates both for the institution and its customers and counterparties; (3) processes for communications with customers and counterparties; (4) a process and plan for operational readiness, including related accounting, tax and reporting aspects of such transition; and (5) the governance framework, including oversight by the board of directors, or the equivalent governing authority, of the regulated institutions. On January 23, 2020, in response to numerous requests from DFS-regulated entities, DFS issued an industry-wide letter announcing that DFS was extending the response deadline by 45 days, until March 23, 2020.⁸ DFS expressly stated that this is the final deadline.

OCC Identifies LIBOR Transition as an Area of Enhanced Oversight

On December 9, 2019, the OCC issued its *Semiannual Risk Perspective for Fall 2019*, which stated that the OCC would be increasing its bank regulatory oversight of LIBOR awareness and preparedness.⁹ OCC examiners will evaluate banks on whether they have begun to assess their LIBOR exposure and potential impacts, as well as risk management strategies.¹⁰ The OCC expects financial institutions to maintain an accurate inventory of "balance-sheet assets, liabilities, and off-balance-sheet contracts that may be affected by a movement to an alternative rate, including assets serviced by third parties."¹¹ One area the OCC identified to help banks determine their risk exposure is the assessment of financial instruments acquired during a merger or acquisition that are not included in the acquiree's primary financial systems. Like other regulators, the OCC identified risks for banks to assess, including: "customer impact, repapering contracts, updating system applications, revising and testing models, and ensuring appropriate contractual fallback language and disclosures to clients."¹² Like DFS, the OCC is focused on ensuring that communications with consumers are easily understood.¹³

The SEC and FINRA Issue Statements on LIBOR Transition Readiness

On December 30, 2019, the SEC released a statement addressing, among other things, the role of audit committees in financial reporting and highlighting key reminders regarding oversight responsibilities.¹⁴ This follows the SEC's July 2019 announcement, discussed in our prior alert, which outlined areas of risk relating to the end of LIBOR's publication.¹⁵ The SEC's December statement noted that the expected

discontinuation of LIBOR “could have a significant impact on financial markets and may present a material risk for many companies.¹⁶ The SEC encouraged audit committees “to understand management’s plan to identify and address the risks associated with reference rate reform, and specifically, the impact on accounting and financial reporting and any related issues associated with financial products and contracts that reference LIBOR.”¹⁷ We expect to see additional statements from the SEC relating to areas of LIBOR transition risk in the coming months.

On January 9, 2020, FINRA issued its 2020 Risk Monitoring and Examination Priorities Letter, which describes FINRA’s 2020 risk monitoring, surveillance and examination programs.¹⁸ Referencing the SEC’s July 2019 statement, FINRA announced that it would be engaging with firms outside the examination program to understand how market participants are preparing for LIBOR’s anticipated cessation. FINRA will focus on LIBOR-related exposure at firms, transition plans, and the impact on customers.¹⁹

CFPB Comments on LIBOR Transition

On October 17, 2019, the CFPB posted guidance on its blog observing that the expected discontinuance of LIBOR could affect various consumer financial products, including adjustable (or variable) rate loan and lines of credit like adjustable-rate mortgages, reverse mortgages, home equity lines of credit, credit cards, auto loans, student loans, and any other personal loans that use LIBOR as an index.²⁰ While aimed at consumers, the CFPB’s post shows that LIBOR transition is on the agency’s radar. The conversion of contracts – and financial companies’ communications with consumers around those conversions – could implicate the CFPB’s authority relating to unfair, deceptive, and abusive acts and practices, as well as other consumer protection laws and regulations.

Implications

Regulators across the globe have emphatically and unambiguously warned financial participants to understand and demonstrate the accessibility and functionality of alternative reference rates, determine how to address the modification of instruments that are projected to require LIBOR beyond the end of 2021, comprehensively assess LIBOR exposure as they work towards developing a robust transition plan, and implement corporate governance structures that ensure appropriate oversight for the transition process. Institutions that fail to heed these clear warnings do so at the risk of enforcement proceedings. That regulators, such as the DFS, are establishing deadlines in the coming months, suggests that they may not wait until after 2021 to begin holding their regulated entities accountable.

Accordingly, in addition to transitioning to alternative reference rates on a going-forward basis, institutions should take steps now – if they have not already – to understand their existing LIBOR exposure. Based on that assessment, institutions will be better positioned to meet regulatory expectations, including by developing a LIBOR cessation plan to manage transition-related risks. Such a plan should include, for instance:

- determining whether and how to convert existing obligations to alternative reference rates and/or incorporating fallback language provisions that identify triggers for introducing an alternative reference rate prior to the end of LIBOR’s publication;
- issuing LIBOR-specific risk disclosures to investors;
- preparing LIBOR-transition communications to counterparties and customers;
- enhancing board and management oversight of LIBOR transition practices and risks; and
- considering legal, reputational, and operational risks associated with changes to LIBOR-based loans.

We will continue to monitor LIBOR transition developments, and we will provide further updates as appropriate.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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¹ See, e.g., *Reforming Major Interest Benchmarks: Progress Report*, Financial Stability Board (Dec. 18, 2019), available [here](#) (last visited Jan. 22, 2020) at 2

² *Id.* at 3.

- ³ *Next Steps for LIBOR Transition in 2020: The Time to Act is Now*, Bank of England, available [here](#) (last visited Jan. 22, 2020).
- ⁴ The mission of the RFRWG is to enable a broad-based transition to SONIA by the end of 2021, across the sterling bond, loan, and derivative markets. As part of this work, the RFRWG consulted on Term SONIA Reference Rates (“TSRR”) in 2018. Following this, it recommended the need for a forward-looking term rate for some participants in cash markets and to support the transition of certain legacy contracts. The prevailing view of the RFRWG is that SONIA compounded in arrears, will, and should, become the norm in most derivatives, bonds, and bilateral and syndicated loan markets given the benefits of the consistent use of benchmarks across markets and the robust nature of SONIA. The future use of a forward-looking term rate in cash markets should be more limited than the current use of LIBOR. So, where possible, counterparties are encouraged to transition to SONIA compounded in arrears.
- ⁵ *FCA and Bank of England encourage switch from LIBOR to SONIA for sterling interest rate swaps from Spring 2020*, Financial Conduct Authority (Jan. 16, 2020), available [here](#) (last visited Jan. 22, 2020).
- ⁶ *Next Steps on LIBOR Transition*, Financial Conduct Authority (Jan. 16, 2020), available [here](#) (last visited Jan. 22, 2020) (emphasis in original).
- ⁷ *Industry Letter: Request for Assurance of Preparedness for LIBOR Transition*, N.Y. Dep’t of Fin. Serv. (Dec. 23, 2019), available [here](#) (last visited Jan. 22, 2020).
- ⁸ *Industry Letter: Request for Assurance of Preparedness for LIBOR Transition (Update)*, N.Y. Dep’t of Fin. Serv. (Jan. 23, 2020), available [here](#) (last visited Jan. 29, 2020).
- ⁹ *OCC Highlights Key Risks for Federal Banking System*, Office of the Comptroller of the Currency (Dec. 19, 2019), available [here](#) (last visited Jan. 22, 2020).
- ¹⁰ *Semiannual Risk Perspective*, Office of the Comptroller of the Currency, available [here](#) (last visited Jan. 22, 2020) at 2.
- ¹¹ *Id.* at 17.
- ¹² *Id.* at 18.
- ¹³ *Id.*
- ¹⁴ *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities*, U.S. Securities and Exchange Commission (Dec. 30, 2019), available [here](#) (last visited Jan. 22, 2020).
- ¹⁵ *SEC Issues Statement Highlighting Risks Regarding LIBOR Transition*, Paul, Weiss (July 18, 2019), available [here](#).
- ¹⁶ U.S. Securities and Exchange Commission, *supra* note 14.
- ¹⁷ *Id.*
- ¹⁸ *2020 Risk Monitoring and Examination Priorities*, FINRA (Jan. 9, 2020), available [here](#) (last visited Jan. 22, 2020).
- ¹⁹ *Id.*
- ²⁰ Davida Farrar, *You might have heard that LIBOR is going away. Here’s what you need to know about LIBOR and adjustable-rate loans*, CFPB Blog (Oct. 17, 2019), available [here](#) (last visited Jan. 22, 2020).