KEY TAKEAWAYS – 2021 UNC BANKING INSTITUTE IN CHARLOTTE

The LIBOR Transition: Mapping the Speedbumps Ahead

With the dates of LIBOR's leaving now set by the U.K. Financial Control Authority, U.S. banks have clear deadlines against which they can measure their readiness. In the wake of the FCA announcement, bank executives, regulators and advisers gathered at the Banking Institute of the University of North Carolina School of Law's Center for Banking and Finance to discuss strategies and considerations in the move to a post-LIBOR world. Highlights included the following:

START WITH THE SCOPE

Managing the LIBOR transition is complicated by the number of variables involved. Banks can define the extent of their transition challenge by identifying which of their [commercial loan?] agreements in force beyond December 31, 2021 reference non-USD LIBOR or one-week or two-month USD LIBOR, and which agreements in force beyond December 31, 2023 reference other USD LIBOR tenors. This inventory should include whether borrowers and syndicates need to be promptly notified in the event of LIBOR's cessation or non-representativeness.

KNOW HOW THE WATERFALLS FALL

Beyond defining the extent of their post-LIBOR exposure, banks need to map out the various components of their agreements' fallback waterfalls. Those components include the priority of the various benchmark options, whether the agreement allows for an early opt-in, whether the floor is imported from the existing loan documentation or is determined independently, and if and when the rate can be flipped to term SOFR, and perhaps most importantly, what the waterfall's terms mean for underlying hedges.

GIVE I.T. A SEAT AT THE TABLE

The shift from LIBOR to alternative reference rates is a Herculean project-management task. But project management is only part of the equation. The transition's success will depend heavily on the ability of a bank's technology leadership to implement the required changes in the institution's data management and risk management, and in operations from the front-office to post-transaction processing. Ensure that those technology leaders are an integral part of the transition planning process from the start.

TAKE A UNIFIED APPROACH

While some transitions specifics will differ between cash and derivatives markets, banks can streamline transition management through coordination between the two categories of agreements. This includes using the same cessation triggers and spread adjustment calculations, and implementing simultaneous amendments of floating rates in loans and swaps. Hedged loans with ISDA fallbacks should use compounded SOFR in arrears.

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CROSS-BORDER ISSUES ABOUND

The LIBOR transition is so challenging because so many agreements are tied to it—but that also shows how useful it has been to have a single, widely agreed-upon benchmark. The disappearance of that benchmark brings a number of jurisdictional issues to the fore. Different agreements will be controlled by different legal regimes. With ARRC legislation still pending at the federal level, states are likely to fill the gap, requiring the navigation of multiple sets of regulations going forward. There is also the question of how the multicurrency cross-border market will adapt to having a range of reference rates, market conventions and regulators.

PREPARE FOR THE IMPACT ON ACCOUNTING

The transition will have significant implications for contracts involving hedge accounting. Institutions will have the option of making an election regarding the accounting methods used in switching to the new reference rates—but only if there are fully documented and validated models and valuations in place. Make sure your accounting team is fully engaged in this process.

A RATE IN THE HAND BEATS TWO IN THE FUTURE

The fact that a greater range of alternative rates may emerge in the coming months makes it tempting to postpone choosing new benchmarks until a broader selection emerges. Institutions that do so, however, risk being unable to execute transactions once deadlines have passed. Firms and advisors can stay ahead of the situation by charting their course based on the rates currently available.

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ABOUT THE PANEL

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