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What Happened To My Interest Rate? Agencies Confirm SOFR Not Required

On November 6, 2020, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (collectively, the "Agencies") issued an inter-agency statement on the transition away from the London Inter Bank Overnight Rate ("LIBOR") that clarifies that prior commentary around use of SOFR as a fallback or replacement rate is a guide and not an edict and, further, each bank should choose a rate to replace LIBOR that is appropriate to its situation and that such rate may include a "credit-sensitive alternative to LIBOR".[1] Recognizing the amount of work that banks need to do in order to implement a smooth transition away from LIBOR, the Agencies are encouraging banks to begin this work now.

ALTERNATIVE REFERENCE RATE

The first step for banks is to choose an alternative reference rate. The Agencies noted that each bank should choose a rate to replace LIBOR that is appropriate to its situation and that such rate may include a "credit-sensitive alternative to LIBOR". The Alternative Reference Rates Committee (ARRC), a group of private-market participants convened to help ensure a successful transition from LIBOR, recommended the Secured Overnight Financing Rate (SOFR)[2] as its preferred alternative for both cash and derivative transactions. Recognizing that each bank's funding models are different and that a one size fits all approach may not work, the Agencies did not recommend a specific replacement rate and made clear that examiners would not criticize banks solely for using a reference rate other than SOFR.

EXTERNAL CONSIDERATIONS

As part of the statement, the Agencies encouraged banks to begin reaching out to their customers and educating them on the transition to a replacement rate. As an element of the outreach, the Agencies made clear that banks should begin actually implementing into new contracts either (a) the replacement rate such bank has decided on or (b) robust fallback language with a clearly defined alternative reference rate for when the LIBOR is discontinued. The Agencies note that incorporating an alternative reference rate or robust fallback language now can help protect both banks and their customers from disruptions once LIBOR ceases to be a viable reference rate.

INTERNAL CONSIDERATIONS

The Agencies, furthermore, encouraged banks to incorporate risk management processes in connection with the transition based on the size and complexity of their exposure to LIBOR. Additionally, the Agencies want banks to review and consider any technical changes that may be necessary for the internal systems of a bank to incorporate the new reference rate that has been decided on.

For more information regarding the transition away from LIBOR, please see What Happened To My Interest Rate? Planning Now To Avoid Value Transfer And Other Risks Upon The Demise Of U.S. Libor, What Happened to My Interest Rate? A Deep Dive into Hardwiring Predictability and Fairness for LIBOR Transition in Loans, Derivatives and other Contracts and THE END OF LIBOR ISN'T SOFR AWAY.

[1] LIBOR is a reference "index" that serves as a primary component of a large number of variable (floating) interest rates in loans, notes, mortgages and other extensions of credit and derivatives based on such interest rates. For reasons beyond the scope of this writing, the U.K.'s Financial

Conduct Authority announced in 2017 that LIBOR will be phased out of existence as a dependable index for variable interest rates no later than December 31, 2021.
[2] SOFR reflects the cost of borrowing in dollars in the daily overnight treasury repo market (i.e., a rate based on overnight loans secured by U.S. Treasuries).

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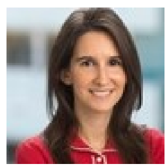

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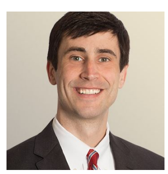

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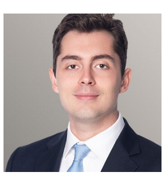

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