

PPG & Spinnaker Consulting
LIBOR Transition Round
Table Takeaways

Executive Summary

- In April 2021, Potomac Point Group and Spinnaker Consulting Group hosted a LIBOR Transition round table. Professionals from super-regional, regional, and mid-sized financial services firms were invited to connect with their peers, highlight unique perspectives and challenges, and share best practices as they progress through the transition from LIBOR
- The majority of attendees were from banking and credit institutions, with additional attendees from related professional services including marketing, legal, and consulting firms
- The hosts of the round table guided conversation about the LIBOR Transition, and focused on topics including:

Choosing a Replacement Rate



AMERIBOR, SOFR, CMT, and other options

Introducing LIBOR Alternative Products



Design new offerings, roll out new products

Managing Execution & Dependencies



Establish holistic transition plans

Remediating Legacy Contracts



Identify exposure, classify language, create remediation strategy

Refreshing Communications



E.g., brochures, websites, customer disclosures

Updating Models, Processes & Systems



Revalidate or create models, Identify impacts, manage updates

- The following pages summarize the information gathered at this session, review major themes, pain points, and operational difficulties, and provide additional resources and guidance

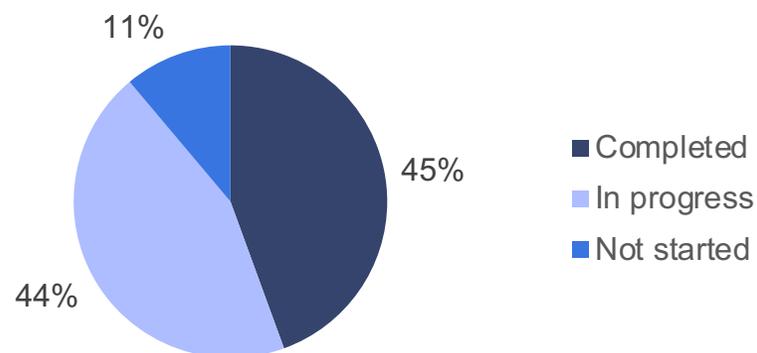
What Round Table
participants had to say...

SOFR, Market Uncertainty, and Alternative Reference Rates

SOFR As Alternative Reference Rate

- Participants acknowledged that SOFR will be the standard for new products, so they are moving ahead while keeping an eye on reference rate alternatives as they develop
 - “[The] general approach is [that] SOFR is the standard, [and is] how we are positioning our front book. But we are still following alternatives to see whether there is additional speculation or motivation for other rates”
- Many of the participants of the round table were already adopting SOFR, even as they acknowledge that there are **continuing market uncertainties**

Where does your organization stand on switching from LIBOR to an alternative rate for new products and contracts by the end of 2021?



Uncertainties with SOFR and Market Alternatives

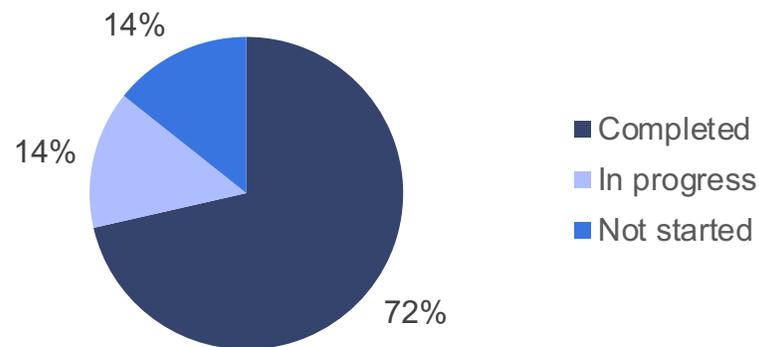
- Even with SOFR as the leading replacement rate, participants highlighted some concerns and uncertainties including lack of history, uncertainty of performance in rate shocks, questions on fundamentals, and the ability to hedge
- There are also concerns over market development and the liquidity of SOFR. Participants noted that as the market still finds its footing demand is building slowly, liquidity is limited, and some are still utilizing LIBOR
 - “There is no trust that there will be the SOFR liquidity we need, [...] that has been the biggest challenge, [it has] fueled the mistrust and created the lack of liquidity.”
- Many are hoping for Term SOFR, but given the uncertainty over its development, they are also exploring other alternatives
 - “If [SOFR] rolled out TERM today, that would be great, but the big question is how can you push liquidity, and get banks to just start originating?”
- SOFR will likely continue to be primary, but some also prefer credit sensitive rates and are closely monitoring alternatives **in addition** to SOFR such as BSBY, BYI, and Ameribor
 - “[...] there are so many groups that are staking their ground on different things, like AMERIBOR.”
 - “Whatever that timeline is, there will be a buffet of indices, but the road to overtake SOFR as a primary is a long one”

Legacy Contract Remediation and Fallback Language

Legacy Contracts and Remediation

- The legacy contract remediation plan is well in hand for the majority of the round table participants. However, this is not the case for all
- Particularly in the commercial space firms will face more challenges as the 2023 deadline looms. Deals are still being written in LIBOR, some without fallback language even in the midst of transition mandates
- For others, with contracts exhibiting significant variation, the push to move off LIBOR will be a manual one
 - “[...] with our population and the changes to SOFR, it’s going to be a brute force attack to those contracts.”

Where does your organization currently stand on establishing a tactical plan for remediating LIBOR-based legacy contracts?



Market Segment Fallback Language

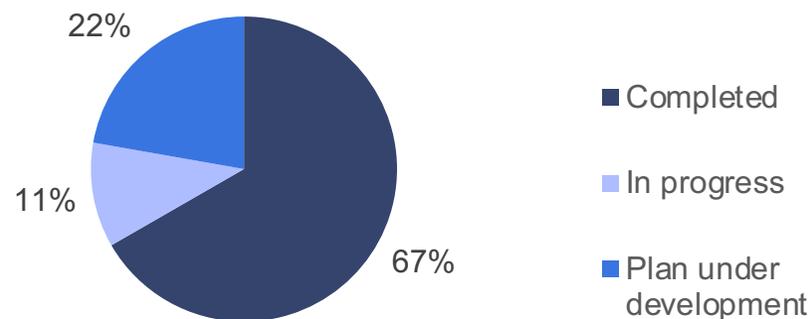
- The consumer segment, with more regulatory criteria, more standards around SOFR and hard-wired fallback language, tends to be further along
 - More regulatory guidance is available – e.g., CFBP, Freddie Mac and Fannie Mae
 - ARRC’s recommended hard-wired fallback language is more widely applicable as written
- Commercial lending may be in a more challenging position due to more contract variation, complexity and the desire for more flexibility
 - Participants mentioned that they are using ARRC’s language in some cases, but modifying in others
 - Modifications are generally geared toward additional flexibility – e.g., to change indices, utilize shorter terms – even to switch on monthly basis in short-term lending, derivatives, swaps.
 - “A group of my clients want ARRC language because it is vetted and approved. For others, [which] are more short term [...] and don’t like ARRC, there are a few renegades that will pick up their own language.”
 - “What we have done and what we have seen is utilizing the ARRC hardwired language. On the bilateral side, we have decided to tweak [...] them”

Managing the execution of the transition

Managing Execution and Dependencies

- With the USD LIBOR transition deadline extension, participants are increasingly dealing with competing priorities
- Other challenges include budget shortfalls and a lack of subject matter experts (SMEs)
- Despite all of these issues and continuing market uncertainty, most have not let it stop their progress
 - “[...] because there has been so much fluidity, we just had a mantra to continue to move forward until it doesn’t make sense.”

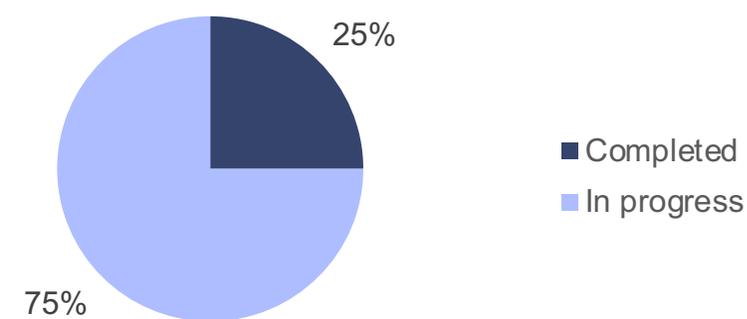
Has your organization established a formal project structure to manage execution and dependencies?



Systems, Models and Processes

- Some participants are taking advantage of the changing environment to implement new technology. They cited the introduction of new software to address legacy contracts including mapping technology, machine learning and other AI
 - “From an inventory analysis [perspective], we did that in early 2019 utilizing AI/machine learning to analyze our contracts across our books to understand what the fallback categorization is.”
- Those relying on vendor systems are expecting those vendors to follow regulatory guidance and update their systems accordingly – most have high confidence in these vendors

How much progress has your organization made on LIBOR transition-related updates to models, processes and systems?

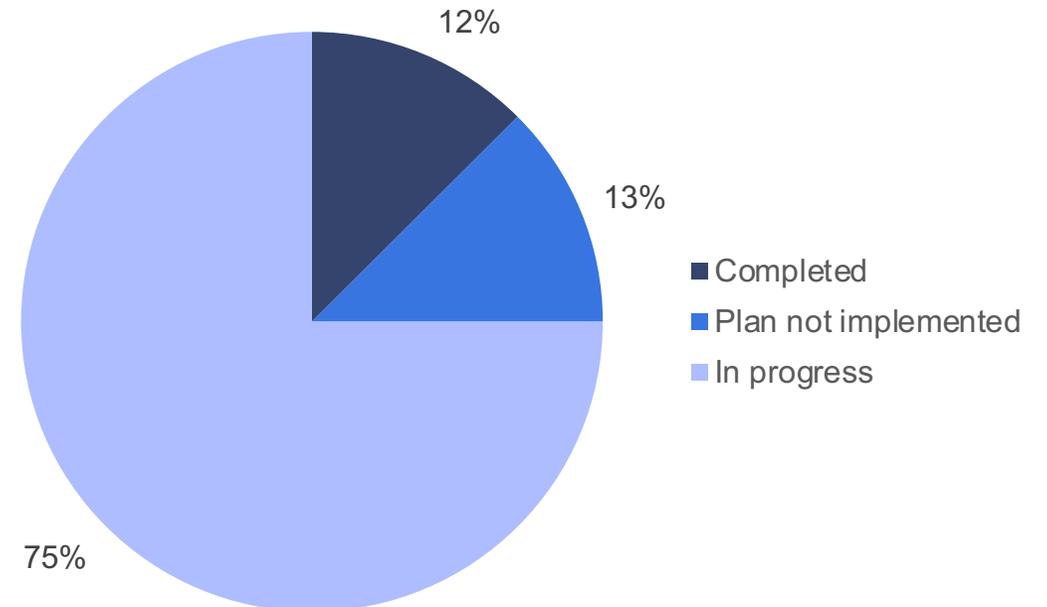


Refreshing Communications

Refreshing Communications

- Communicating changes was highlighted in both sessions as a challenge that most participants are still in the process of tackling
- Communications will be dependent on loan type for many institutions that participated in the round table
 - For consumer loans, more guidance on communication is already available on transition websites
 - For more complicated commercial loans, firms are generally providing marketing and communication materials but relying on their relationship managers to assist clients individually
 - “We are trying to plan for communication with borrowers. We are taking it day by day in that regard so we are ready with the data so we can push go when we get more direction”
- They specifically highlighted a gap between high-level and very technical information – more sophisticated customers need more detail, but still want “plain English” explanations
 - “I think everyone is asking for something more than the high level, but when they do get it it’s too hard and granular. There needs to be something in the middle so you could guide them through this whole process”

Where does your organization stand on refreshing communications such as websites, market materials, customer disclosures, etc.?



What does it all mean for
LIBOR transition efforts?

With all the uncertainty, many questions remain

How will SOFR develop and perform?

- With no history to rely on – how will SOFR perform? Relative to other indices? Through rate shocks, liquidity events?
- Will there be a term structure?
- How do you hedge?

Will SOFR alternatives emerge?

- How significant is the need for an alternative among smaller players, non-banks?
- What is the true demand for credit sensitive rates?
- Will there be multiple rate or spread adjustment options by 2023?

When will new markets pick up steam?

- How does liquidity build when demand is soft?
- What will incent lenders and borrowers to do more deals in alternative rates, drive standardization?
- Who can fill information gaps to bolster education and communication efforts?

Will we get legislation for legacy contracts?

- NY law helps, but will there be federal legislation?
- What about conforming changes? Consent requirements?
- Impact on securitizations – i.e., Trust Indenture Act?

What more can we expect from regulators?

- Most parties want more regulatory guidance – will it come with enough lead time to act on it?
- Will there be more prescriptive mandates?

Uncertainty calls for continued engagement and flexible approaches

Underlying is the fundamental tension between regulation and market-driven change – quick resolution isn't likely. Implementation teams must move forward with what they know, and continually adapt as the new market evolves.

Connect with peers and actively engage

- The pace of updates and market developments isn't likely to slow – create strong peer networks and leverage industry sources to stay well-informed
- Help bolster market confidence by joining forces with industry peers to advocate for clarity and action from Congress and regulators
- Push relevant organizations for more clarity on rate fundamentals, relative performance, etc. – e.g., raise SOFR questions to the ARRC, Ameribor questions to AFX
- Actively monitor new deals, transaction volumes, market performance for SOFR and other alternative rates
- Seek out and share resources for training and communication
 - Ask ARRC, MBA, ISDA, other industry groups for plain English explanations
 - Collaborate to identify and fill in gaps

Adopt flexible execution approaches

- Move forward with SOFR where it makes sense, but recognize that one size may not fit all going forward – e.g.,
 - Compound average SOFR and hard-wired fallback language may work for consumer loans
 - Commercial lending can benefit from the same constructs, but may call for more flexible terms
- Move forward in areas of relative certainty, but adopt (and budget for) continuous monitoring, planning and execution cycles
 - Front-load model, system and process updates for SOFR where applicable
 - Monitor and analyze / model alternative rates as they emerge
 - Expect and budget for adjustments and iterative execution as details become clear, new rates emerge, etc.
- Conduct iterative communication and training – leverage existing high-level material, continue to drill down as more becomes available

Resources

- [ARRC Progress Report](#)
- [ARM Resource Guide](#)
- [MBA Communications Templates \(Notice\) \(Letter\)](#)
- [MBA Commercial Transition Primer](#)
- [OCC Libor Transition: Self-Assessment Tool for Banks](#)
- [ISDA 2020 IBOR Fallbacks Protocol](#)

Thank you to all of our Round Table participants!

Please contact us with any questions or ideas for additional networking and information sharing on the LIBOR Transition.

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