Six Steps Your Institution Should Take Towards SOFR

hedging lending SOFR

Summary: The transition from LIBOR to SOFR has been in the works for a while. But, now is the time to face it head-on. We give you six important steps to take right now to ensure you are compliant by the time LIBOR retires: organize your team, make a plan, communicate with stakeholders, assess exposures, remediate contracts, and set up operational readiness.

A day on the planet Mercury is actually equivalent to two Earth years. Talk about having more time in the day! Many bankers wish that they had more time in the day to address the many projects on their plate lately.

Although the implementation of CECL and the myriad of issues related to PPP loans have dominated bankers' time, it is important to keep the upcoming transition from LIBOR to SOFR on top of mind as well. It remains one of the regulators' top areas of focus for this year, with the adoption deadline set for December 31, 2021.

Back at the beginning of this process, the Federal Reserve commissioned the Alternative Reference Rate Committee (ARRC) to develop a replacement benchmark for LIBOR. The ARRC established the Secured Overnight Financing Rate (SOFR) as the most reliable replacement. SOFR was recommended primarily due to its daily volume of transactions and reliability as a benchmark.

The ARRC recommended that financial institutions stop issuing any new LIBOR-based loans as of June 30, 2021, in anticipation of the last publication date for LIBOR on December 31, 2021. While it was recently announced that the transition will be extended to June 30, 2023, for some rates, including 1-month, 3-month, 6-month, and 12-month US LIBOR rates, don't take your foot off the pedal.

Six important steps to take right now.

1. **Organize a strong transition team.** It should include members from credit, finance, lending, and risk. Make sure that you identify key senior management for oversight. Your board must be updated regularly on the progress.
2. **Make a plan with a process.** The entire financial institution should be included in both parts, plan and process. Identify specific customer exposures and address all products involved with LIBOR. Establish an end date for LIBOR-based assets and stick with it. Replacement rate language, provisions, and conventions will also have to be specified.
3. **Communicate with all stakeholders.** Create an effective communication plan for customers, counterparties, and all stakeholders – internal and external. When appropriate, discuss the details with your legal and accounting firms. Set up a timeline for communications and make sure all parties feel confident with the steps needed in the transition. Build-in extra time in case more explanation is needed.
4. **Assess exposures.** Evaluate all on and off-balance sheet exposures to find LIBOR references and measure appropriately. This will be needed for all existing and new LIBOR-based assets through 2021. For each exposure, implement fallback language or consider replacement products.
5. **Remediate contracts.** Review all contracts that reference LIBOR with a maturity beyond 2021. Assess customer, financial, and legal implications with your team and resolve them based on the risk level.

6. **Start to set up operational readiness.** Evaluate if you will need updated technology and models for this substantial change. Assess training needed for the various departments. Verify tax and regulatory requirements as well. Incorporate these into the timeline.

This may seem like a daunting project. But, there are several places to go for assistance. Regularly review the ARRC site for the latest information. Check with your peers to see what they have done. This is a transition that all financial intuitions are going through, after all! Lastly, feel free to contact us for additional tips. We are happy to help as we are moving through this transition too.