The Arizona Banker

PUB. 11 2021 ISSUE 3

Banking On Inclusion:
America's Banks Embrace Bank On Movement page 6

Official Publication of the Arizona Bankers Association

Four Critical Reminders to Transition from LIBOR to SOFR

TIME IS TICKING AWAY WITH LIBOR'S discontinuation, and regulators are urging financial institutions to act now to ensure a smooth transition. While we have been reporting on this since the announcement of LIBOR's cessation was made, it is increasingly important to get preparations in order.

As bankers know, LIBOR has been the most widely used benchmark for floating rate transactions. So, community banks will need to be diligent in uncovering all areas of exposure. Although the derivatives markets account for an estimated 95% of the total exposure volume, USD LIBOR is also the reference rate in several trillion dollars of corporate loans, floating-rate mortgages, floating-rate notes, and securitized products. Specific to community banks, LIBOR may be used in some loan products, as well as tied to interest-rate hedges.

LIBOR has already been discontinued in some global markets, while the U.S. extended its end date to mid-2023, due to disruption from COVID-19. Many financial institutions continue to take a wait-and-see approach and have delayed starting on the transition. Some bankers may think they still have plenty of time to address the issue or that there will be more guidance coming from government agencies on the transition. However, it is prudent to act sooner rather than later. Furthermore, regulators have emphasized that entering into new LIBOR exposures after 2021 would create safety and soundness risks and they would examine institution practices accordingly.

As we move closer to the sunset date for LIBOR, the below four reminders become more critical to get you where you need to go for the smooth transition from LIBOR to SOFR.

Reminder 1: Assess your LIBOR cessation exposure risk. Management should consider all applicable risks, such as operational, legal, compliance, strategic, and consumer risks, when conducting LIBOR cessation preparedness assessments. While we have noted this in previous articles, it is the key to proper transitioning. To assist with that effort the OCC has introduced a Self-Assessment Tool for Banks. This tool can be used to analyze:

- The appropriateness of a LIBOR transition plan
- Management's execution of the transition plan
- Related oversight and reporting

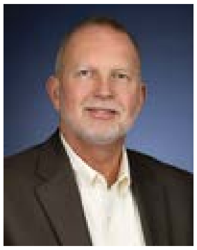
Reminder 2: Create a tailored plan. This needs to address the specific risks and exposure. Some common steps in a preparedness plan include modifying contracts to include "fallback" language, addressing operational risks, and communicating with affected customers and third parties.

Reminder 3: Devise a solid timeline for transition. The Federal Reserve continues to emphasize that financial institutions should stop writing contracts using LIBOR by the end of 2021. After that, the one-week and two-month LIBOR rates will no longer be published. Also, agencies have issued recommendations that LIBOR assessments and cessation preparedness plans should be at near completion with appropriate management oversight and reporting before the end of 2021.

Reminder 4: Staying on track. Once the assessment, plan, and timeline have been done, it is important to review these regularly. Management should assess whether the progress with preparedness is sufficient for meeting transition deadlines and adjust as needed.

We know how important it is to stay on track since we are preparing for the transition from LIBOR to SOFR as well.

To continue this discussion on LIBOR's transition or for more information, please contact Jay Kenney.



Jay Kenney SVP & Southwest Regional Manager for PCBB. He can be reached at jkenney@pcbb.com.

Dedicated to serving the needs of community banks, PCBB's comprehensive and robust set of solutions includes: cash management, international services, lending solutions, and risk management advisory services.