How Best to Navigate the LIBOR Transition:

Challenges and Solutions for Corporate Treasurers and CFOs

November 2020

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First Things First:
The Building Blocks for a Successful Transition

While this guide discusses several specific tasks for corporates to take on as the transition deadline approaches, a transition must be premised on a sound governance framework, a detailed project plan and a full identification and analysis of the various existing exposures and dependencies tied to LIBOR and other IBORs. They form the building blocks for a successful transition, underpinning all the tasks discussed in this guide.

Good Governance – A sensible governance framework for navigating the transition is essential. At a minimum, this means ensuring that senior management is engaged and that there are clear lines of responsibility and reporting. In some cases, a separate working group, steering committee or task force will be established to manage the transition; in other cases, the transition will be administered principally through individual business units with legal, accounting and other functions playing supporting roles. However, in all cases, corporates should adopt a framework that answers how the firm is going to execute, manage and monitor the transition to minimize legal and business risks. There is no one-size-fits-all framework, as many corporates have already realized by this point in the transition.

Project Planning – Corporates need to have an enterprise-wide project plan that encompasses input from key constituencies within the organization. The plan should be informed by the firm's overall strategy and goals for the transition, such as avoiding value transfer and mitigating operational risk. It should also have specific timelines for transition-related milestones, including with respect to contract inventorying and analysis, negotiation and "repapering" tasks, and "switching off" IBOR-related processes and infrastructure. Updates to reflect insights from regulators, standard-setting bodies and industry "best practices" should be made as necessary.

Review and Analysis – A comprehensive review should be conducted of every contract, system, model and process for references to LIBOR or other IBORs. Exposures should be identified and catalogued. Merely finding contracts can, in many cases, be one of the most difficult aspects of the transition, especially for corporates with multi-national operations or that have grown through mergers and acquisitions. Reviews may entail representative sampling and internal questionnaires before maturing to more extensive scoping exercises. They also may be aided by data extraction technologies.

Introduction

The London Interbank Offered Rate ("LIBOR") is deeply rooted in trillions of dollars of financial products across currencies, jurisdictions and asset classes. It has been called the "world's most important number," owing to its pervasive use and critical role in the financial system. It is also going away. Global regulators have, in various ways, signaled the end of LIBOR by the end of 2021. Banks and other financial institutions have been actively directed to prepare for the "transition"—from LIBOR to alternative reference rates—by formulating plans, amending contracts and readying systems.

But what about corporates?

The LIBOR transition is not simply a "bank problem." LIBOR's cessation as a critical benchmark or reference rate presents specialized challenges for corporates because they are direct "users" (*i.e.*, buyers and counterparties) of LIBOR-based products. In addition, corporates rely on LIBOR in critical internal systems and risk models. They also use LIBOR in pricing mechanisms and for other purposes in various types of contracts, from purchase agreements to vendor agreements.

The looming LIBOR transition deadline of year-end 2021 presents a tight timetable. Given the vast quantity and array of financial transactions that are subject to LIBOR, and the fact that LIBOR is embedded in critical financial and treasury management processes and systems, the work still required to be done by corporates and other market participants is extensive. While COVID-19 has exacerbated the situation by diverting management resources to pandemic-related areas, not even a pandemic will delay this transition.

Yet the path to replacing LIBOR is, and remains, a complex one. Despite the seemingly constant drumbeat of official speeches and white papers, there are many unresolved issues facing corporates, not least the concerns on certain mechanics relating to the various so-called risk-free rates ("RFRs") that are intended to replace LIBOR and other IBORs.

By this point in the transition, the largest financial institutions already have sophisticated programs for the replacement of LIBOR in place. The regulators have effectively required them to take the lead in this evolving picture. Other institutions have yet to ramp up fully. If there is a benefit for those latecomers, it is that they can learn from experiences of more advanced firms and recent regulatory guidance. In all cases, however, there is still some work that can—and should—be done to ensure a smooth and seamless transition.

This guide is specifically designed for corporates navigating the LIBOR transition. For a successful transition, corporates should be taking five key steps:

1. Take Stock of Their LIBOR-based Products, as Issuers and Buyers
2. Minimize Potential Mismatches Between Existing Obligations and Matching Derivatives
3. Analyze Material Risks and Formulate Risk Mitigants
4. Plan How Best to Convert Systems and Amend Legacy Contracts
5. Prepare for Communications and Regulatory Engagement

Our guide discusses each of these steps. While others are most certain to arise in the course of transition-related work (a checklist of other key tasks is provided on page 25), we believe these steps set the stage for proper and thoughtful engagement by those within the corporate treasury and financial function to advance a firm's transition away from LIBOR.

Step 1

Take Stock of LIBOR-based Products

The first step for corporates will be to identify the scope of potentially affected contracts and instruments and assess how the legacy fallback language, if any, works. Categorizing affected contracts and instruments in a manner that prioritizes the economic impact to the company and the relative ease or difficulty of amending them will be essential for a successful transition.

IDENTIFY ALL CONTRACTS GIVING RISE TO LIBOR EXPOSURES

Nearly every critical transition task—from examining fallback language to creating a risk inventory to designing and executing a remediation strategy—depends on the comprehensive identification of contracts and financial instruments that reference LIBOR and mature after 2021.

As corporates can be both issuers and buyers of LIBOR-based products, attention should be given to the many areas where LIBOR may be used:

- **Transactions with Banks and Other Financial Institutions**
  It is important to examine transactions with financial institutions, which include bank loans and other financings, including revolving lines of credit, term loans, bonds, floating rate notes and asset securitizations. In addition, corporates' exposures arising under a range of derivative contracts (*e.g.*, interest rate swaps, forward rate agreements, cross-currency swaps) must be considered.

- **Transactions with Affiliates and Related Purposes**
  The position of affiliate exposures should also be considered, which includes inter-affiliate and intra-group loans (including for daily cash concentration and disbursement) and employee benefit plans that invest in LIBOR products. In addition, various calculations used when documenting affiliate transactions could be implicated (*e.g.*, interest capitalization, lease valuations, fair value calculations).

- **Transactions with Non-Financial Counterparties**
  Non-financial institution exposures need inclusion also, where they comprise various kinds of commercial transactions, such as with suppliers and customers. For example, asset purchase and sale agreements may reference LIBOR for adjustments to earnout calculations, and vendor contracts and similar agreements may use LIBOR for calculations relating to late payments and other terms.

Other types of contracts and instruments that rely on LIBOR may come to light in the course of discussions with representatives of various business units and desks. Conversations and questionnaires may yet reveal subsets of documents that reference LIBOR which were not top-of-mind during initial scoping. There also may be ancillary documents that are implicated by rate changes in agreements that use LIBOR, or others that have hedging mechanisms based on it. Active involvement by the corporate treasury function will be valuable to ensuring that all relevant contracts and instruments are identified. Adequate investment of time and resources from the corporate treasury function during this step will also help obviate the need to re-run searches for certain documents or clauses and will reduce the need for multiple conversations with business units.

As we approach the end of 2020, many corporates may have already started collecting relevant contracts (for those with significant LIBOR exposures, scoping will likely have been aided by technological tools for data extraction), but outliers will need to ramp up fast given how other transition tasks depend on the quality of this step.

For convenience, this guide focuses on the transition from US Dollar LIBOR to the Secured Overnight Financing Rate ("SOFR"), which is the preferred alternative reference rate by the US Alternative Reference Rates Committee ("ARRC"), a body established by the US Federal Reserve and comprised of banks and other market participants. However, many of the same issues and considerations raised in this guide apply to the transition away from other IBORs to new RFRs.

Key Components of Fallback Language	
TRIGGER EVENT	Define the circumstances, under which, references to LIBOR, in a contract, will be replaced with an alternative reference rate
BENCHMARK REPLACEMENT RATE	Identifies the new reference rate (such as SOFR), or waterfall of rates, that would replace LIBOR following a trigger event
TERM AND CREDIT SPREAD ADJUSTMENT	An adjustment (which may be positive, negative or zero) added to the benchmark replacement rate to account for fundamental differences between the current benchmark rate (LIBOR) and the benchmark replacement rate (such as SOFR)
AMENDMENT AND CONSENT MECHANICS	Specify how the contract can be changed (*e.g.*, majority consent of syndicate lenders, consent of all parties to an OTC derivatives contract)

EXAMINE FALLBACKS IN EXISTING CONTRACTS AND LIABILITIES

Fallback language refers to the contractual provisions that specify the process for determining a replacement rate in the event the agreed-upon rate is unavailable. Existing fallbacks in contracts are generally viewed as not suitable, or "robust," because they were designed to address circumstances in which LIBOR becomes temporarily unavailable (such as a computer glitch affecting the designated screen page or a temporary market disruption), rather than a permanent cessation. Fallbacks also may be unclear on the process for selecting a replacement rate or require actions that are simply impracticable. For example, Appendix A contains a sampling of typical fallback provisions in LIBOR products, certain contracts (*e.g.*, floating rate notes, OTC derivatives) require calculation agents to solicit or poll banks for a fallback rate, but it is highly unlikely that banks will continue providing quotes after 2021. Among other reasons, this is because there is no established process for reference banks to respond to post-cessation LIBOR polls; no such post-cessation polling has been tested on a wide scale; and the volume of contracts that implicate polling make it operationally burdensome for banks to even respond to polling requests. Contracts may also require unanimous consent for changes to rate terms. Adding further complication to the dilemma faced by market participants is the fact that some products contain fallbacks which, if triggered, could result in economically undesirable outcomes for certain parties, including corporates.

Corporates need to examine carefully the fallback language in existing contracts and liabilities. This need not be done all at once. Some companies may wish to scope a representative sample of their LIBOR exposures to assess the strength of fallback language and then refine the analysis before conducting a comprehensive review. In any event, two types of review should drive this task:

First, identify where existing fallback language—or the lack of it—produces uncertainty or economic mismatches between what the parties intended at the time they entered into the relevant contract and what could occur as a result of LIBOR's cessation. For example, most floating-rate notes contain fallbacks that will result in the notes becoming fixed-rate obligations if quotes are not received under bank polling provisions. Similarly, most securitization bonds will convert to a fixed rate (*i.e.*, "last LIBOR") upon LIBOR's cessation. Other contracts, including many syndicated loans, can potentially shift from LIBOR to a much higher Prime Rate, significantly increasing costs to the company.

Second, analyze and confirm the operative legal language that may be used to deal with the unintended economic outcomes. Attention should focus on trigger events, the appropriate fallback rate and whether spread adjustments are needed to account for the fact that SOFR and other risk-free reference rates will quote lower than LIBOR and other IBORs. Spread adjustments will be critical to ensuring that the value allocation of the original contract is preserved. For additional background on fallbacks and related issues, see Appendix B.

Corporates examining fallbacks through these two types of reviews will be best prepared to then strategically categorize those contracts and instruments needing remediation.

Corporates should analyze their exposure to LIBOR, by currency and instrument, and determine a profile for that exposure by time. The derivatives markets and the cash markets may treat a cessation of LIBOR in different ways, so gross and net exposure in different markets may also be important.

CATEGORIZE CONTRACTS AND INSTRUMENTS NEEDING REMEDIATION

Next, corporates should meaningfully categorize exposures warranting low- to high-level remediation actions, prioritizing (i) the economic impact to the company and (ii) the ease (or difficulty) of making amendments. For the economic impact to the company, the principal goal is to minimize the risk of value transfer. As noted previously, most floating rate notes will fall back to a fixed rate, leading to situations where, according to the ARRC in March 2020, "[t]here will be winners and losers as the values associated with such transactions change from what was expected and intended." Therefore, contracts and instruments that are the most material to the company from a financial perspective should be given priority for management's attention and for other steps in the transition, such as initiating counterparty communications.

Contracts must also be categorized in a manner that recognizes the practical circumstances surrounding their likelihood of amendment. Corporates should group contracts logically, based on counterparty type and product type. Counterparty types generally include intra-group and other affiliates, corporate counterparties, and financial institutions. Intra-group exposures, for example, will likely be the easiest to remediate for many reasons, including the possibility of entering into a global amendment containing universal replacement provisions. Conversely, pursuing amendments with a diverse array of financial institutions may involve opaque processes and differing views on fallback language or other key terms. In addition, product-type categorization is necessary (*e.g.*, cash products, derivatives products). Any hedging documentation should be placed in the same group as the loan documentation they relate to for ease of analysis. This categorization work will help identify those contracts that require negotiation and those that may be remediated more easily through adherence to the International Swaps and Derivatives Association's ("ISDA") framework (the "Protocol") for amending derivatives contracts, which account for the vast majority of outstanding LIBOR exposures. The Protocol takes effect on January 25, 2021, and is discussed in Step 2 of this guide.

Step 2

Minimize Mismatches Between Obligations and Derivatives

Firms need to address the potential mismatches that could arise between cost of funds and incoming payments, created by adjustments to its hedging arrangements. While the industry has worked to develop fallbacks to LIBOR that will be as consistent as possible across product types, in practice, recommended fallbacks may vary between the cash market and the derivatives market.

As a result, industry-recommended fallbacks may not be appropriate for more bespoke products; they may not be possible to negotiate; and they may not be aligned at the time of the transition away from LIBOR. A firm's working group relating to LIBOR planning should devote substantial focus to minimizing any risk of mismatch. In particular, the working group needs to evaluate the company's asset/liability risk profile for mismatches underlying exposures and market financing, scope out potential actions for the company's future hedging needs under a variety of adverse scenarios and identify off-the-shelf market or more bespoke solutions, as appropriate. Set out below are a few of the main areas that corporate treasurers should be aware of where mismatches may arise.

CASH MARKET VS. DERIVATIVES MARKET

Industry groups have proposed recommended fallback language that may be used in the transition away from LIBOR. While the ARRC has led the cash market in the US in the development of recommended fallback language for new loans and amendments to existing loans, ISDA has developed recommended fallback language for derivatives in the IBOR Fallbacks Supplement to the 2006 ISDA Definitions for new derivatives and the ISDA IBOR Fallbacks Protocol for existing derivatives transactions.

The industry is generally embracing SOFR, the ARRC-recommended risk-free rate, as an alternative to USD LIBOR. However, SOFR and LIBOR differ in a number of ways. To ensure that fallback rates incorporated into contracts remain as economically similar as possible to the original rate, SOFR must be adjusted. In particular, SOFR must be adjusted to account for the fact that LIBOR is a term rate, while SOFR is an overnight rate, and LIBOR incorporates credit risk, while SOFR is a risk-free rate. In both the ARRC- and ISDA-recommended fallback language, two adjustments are required: (i) to address the difference in term, a term adjustment is made to SOFR; and (ii) to address the difference in credit risk and other differences, a spread adjustment is added to the term-adjusted rate.

While both the loan market and derivatives market are taking very similar approaches to the fallback rates, they are not identical, and firms using derivatives instruments to hedge loan transactions should be aware of any discrepancies. Differences are most likely to arise with respect to the term adjustments. To adjust for term, as SOFR is an overnight rate, it must be averaged, and there are different approaches as to how such averages are determined. Further, while the ISDA IBOR Fallbacks Protocol eases amending legacy derivatives contracts, no such mechanism currently exists to amend legacy loan contracts. There may also be a mismatch to the extent fallback language is adopted in certain instruments, but not other related instruments.

Term Adjustment

The ARRC has generally recommended use of a forward-looking term rate for cash markets, which is expected to be developed in 2021. Development of this rate will first depend upon development of sufficient liquidity in the SOFR-linked derivatives market. The term rate would be set in advance and would reference an average of SOFR observed before the beginning of an interest period. Most contracts currently referencing LIBOR set the floating rate based on the value of LIBOR in advance (though some swaps reference the value of LIBOR at the end of the interest period, or in arrears) so a forward-looking term rate would be the most consistent with LIBOR. The ARRC has published a request for proposal to vendors to develop a forward-looking term rate. Once a vendor has been selected, there will be greater clarity with respect to the specific formula used in that rate.

While the ARRC recommends the use of a forward-looking term rate as the primary potential successor rate, it also does not recommend that financial market participants wait until this rate exists to begin using SOFR in cash products. In the meantime, if a term SOFR is not available, the ARRC has recommended a waterfall of other alternative rates depending upon product type and availability, including daily simple SOFR or compounded SOFR.

ISDA has recommended use of a compounded setting in arrears rate to address the difference in tenor between an IBOR and a risk-free rate. This rate represents the risk-free rate observed over a period of time that is generally equivalent to the relevant IBOR tenor (*e.g.*, three months for three-month US dollar LIBOR) and compounded daily during that period. It is calculated and published on a daily basis for each relevant IBOR tenor by Bloomberg. Bloomberg also applies a two-business day "backward shift" to this rate to ensure that parties will know the rate two days in advance of the payment due date.

Given that the ARRC's and ISDA's recommended rates are calculated over different time periods, there may be a basis difference between an "in arrears" and "in advance" rate, depending upon whether interest rates are trending up or down or flat over a given period. On average, differences likely net out over the life of a loan or financial instrument that lasts more than a few years. However, in a particular period, there may be differences that could result in either a gain or loss from one structure relative to another. These differences can also depend on the frequency of payments.

Spread Adjustment

Both the ARRC and ISDA have recommended a spread adjustment be added to the term-adjusted risk-free rate. ISDA has recommended that this be based on the historical median over a five-year lookback period approach as published by Bloomberg.

For cash products other than consumer products, the ARRC has recommended a spread adjustment that will match the value of ISDA's spread adjustments to USD LIBOR and has recommended a one-year transition period for consumer products, during which the ARRC will further consider the most appropriate approach as to whether applying the ISDA spread adjustment methodology or value for these specific products.

Other than potentially with respect to consumer products, misalignments due to the spread adjustment are unlikely to create issues.

LIBOR's cessation may create mismatches between the loan product and the related hedge. Implementing a legal process for identifying and minimizing these mismatches will be an important goal for firms.

Timing of Fallback Language Adoption

In adopting fallback language, firms should consider the effective date of implementation of the ISDA IBOR fallbacks and the implications this may have with respect to any related cash products.

The ARRC has recommended that firms already have hardwired fallbacks incorporated into new floating rate notes, syndicated loans, securitizations and consumer loans by now and incorporate them into bilateral loans by October 31, 2020.

As adherence to the Protocol and adoption of fallback language is voluntary and does not necessarily happen automatically or simultaneously, firms should ensure that hedged instruments are adopting fallbacks in the appropriate timeframe such that the economics of the instruments remain consistent.

ISDA has recently launched the IBOR Fallbacks Supplement to the 2006 ISDA Definitions and the ISDA 2020 IBOR Fallbacks Protocol on October 23, 2020, taking effect on January 25, 2021. Market participants are encouraged to adhere to the Protocol by then, but adherence is not mandatory and there is no cut-off for adherence.

NON-LINEAR DERIVATIVES

Implementing the IBOR fallbacks recommended by ISDA into non-linear derivatives products may require additional analysis to understand how the fallbacks work in such products and whether it is appropriate to directly incorporate the fallbacks or to modify the fallbacks. To facilitate this analysis, ISDA has published a Product Table that explains the effect of the fallbacks upon various non-linear products and potential related issues. ISDA has also published bilateral amendment template language that counterparties may use instead of the Protocol to modify their derivatives. Bilateral amendments give parties greater flexibility to ensure that the fallbacks do not impact these products in unexpected ways or in ways that would change the economics of the transaction. ISDA has in particular noted that, for certain products, parties may wish to consider amending the definitions of business days or payment dates or agree to use a fallback rate for a date other than a particular IBOR's original fixing date. In some cases, this may better align the outcomes with the parties' original intentions and/or with the desired outcomes for hedged instruments.

FOR THE TO-DO LIST

To summarize, as corporates head into 2021, they should be doing the following:

- Ensure that their LIBOR-related working groups are evaluating their asset/liability risk profiles for hedging-related mismatches;
- Scope out options for the future hedging needs;
- Understand industry-led solutions in the form of model provisions and evaluate the appropriateness of their use in specific cases.

Step 3
Analyze Material Risks and Formulate Risk Mitigants

Prudent risk management involves an assessment of the material risks raised by a company's exposure to LIBOR and its cessation. Both regulators and boards of directors will expect companies to have analyzed transition-related risks, with granularity increasing as the expected cessation date nears. Corporates therefore should ensure they have created a thoughtful inventory of risks and their corresponding mitigants.

CREATE A RISK INVENTORY

Corporates use LIBOR for various financing needs and for a wide range of treasury management purposes. As a result of these uses, and the need to address legacy contracts and instruments maturing after 2021 (including those with additional new fallback provisions), the transition away from LIBOR has revealed a spectrum of commercial implications and risks for corporates. A full description of these risks is provided in Appendix C. As a matter of priority, a risk inventory should be created to identify institution-specific risks, including those which fall within the following risk groupings:

- **Economic Risk** – Economic risk arises because, put simply, IBORs are not the same as risk-free rates. IBORs are term rates and contain an inherent credit spread because they are the rate at which banks lend to each other. By contrast, SOFR and other RFRs are overnight rates that are secured by Treasury securities in a repurchase contract. A change in benchmark rates could lead to interest rate risk, affecting values of investments and changing funding costs. There may also be basis risk from different transition timing across markets or asset classes. Certain fallback provisions, even if recommended by the relevant authorities, could lead to adverse changes to product economics. In addition, for so-called "tough" legacy contracts lacking viable solutions, corporates may find these to be costly to exit.

- **Legal and Litigation Risks** – Legal and litigation risks naturally arise from the actual or perceived transfer of economic value from one party to another as a result of a shift from LIBOR to an alternative rate. Parties may dispute proposed fallback language and replacement rates and the adequacy of compensation to rectify imbalances. Claims could be brought under breach of contract, unjust enrichment, or impossibility of performance, among other causes of action.

- **Tax Risk** – There may be tax consequences of adding fallback language to outstanding debt (whether bonds or borrowings under credit agreements) and other financial contracts that reference LIBOR, as well as amendments to change the reference rate. Tax consequences might also arise as a result of payments to adjust for differences between reference LIBOR and the replacement rate. As the transition nears, regulators have been working to address many open tax issues. For example, on October 8, 2019, the US Treasury Department issued guidance confirming that taxpayers who modify contracts to include certain alternative or replacement rates may not be considered to have exchanged property for purposes of US taxation. The relief generally applies to derivative contracts, debt instruments, insurance contracts and lease agreements. On October 9, 2020, the IRS released Revenue Procedure 2020-44, which provides welcome guidance by making clear that when a contract is modified to include an ARRC Fallback Provision or ISDA Fallback Provision, such modification should not result in the recognition of gain or loss.

- **Accounting Risk** – The phase-out of LIBOR has wide-ranging accounting impacts for loans, derivatives and other financial contracts across the five LIBOR currencies. Accounting standard-setting boards, including the US Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board, have issued relief on certain issues.

- **Operational Risk** – Operational risk arises from processes, systems and models being unprepared to support alternative rate products, such as new overnight-rate-based floating rate notes. Operational readiness issues are discussed in Step 4 of this guide.

The transition is fundamentally a risk management exercise. The unprecedented nature and scope of the work complicates this task, but it does not change it. As the transition heats up, companies may need to consider the adequacy of existing disclosures on the transition.

The nature and specificity of these and other risks will, of course, vary among companies and industries, but a risk inventory is a common, necessary task. Staff of the US Securities and Exchange Commission ("SEC") have recently indicated that some companies may be requested to provide examiners with documentation relating to risk inventories and a description of any transition-related vulnerabilities. SEC staff also have acknowledged that internal task forces or working groups may need to be established to specifically oversee and manage these risks.

IDENTIFY RISK MITIGANTS AND ASSESS THE NEED FOR SPECIALIZED ACTIONS

Next, corporates should formulate potential mitigants to address identified risks. The inventory of risks discussed earlier will inform a taxonomy of potential mitigants and other responses. The corporate treasury function should be highly active in this process. Treasury and finance staff should not only run models to quantify how loans, derivatives, swaps and other contracts will be affected, but support the design and negotiation of credit spreads or term adjustments to ensure that a new benchmark rate is as economically similar as possible to the rate being replaced. Staff will also be critical in aiding other functions and units (*e.g.*, legal, reporting) in responding to regulatory and investor inquiries.

A thoughtful risk mitigation exercise also will help a company make a number of important decisions. Among other things, corporates will be able to make more informed decisions on the nature of any disclosures that may be needed to comply with applicable law or that are otherwise advisable for the maintenance of good relations with investors, suppliers or other counterparties. Corporates also will be able to make budgeting, forecasting and other related decisions for the near-term based on a more robust understanding of LIBOR-related risks and potential mitigants.

New Contracts Today, Legacy Contracts Tomorrow

What should corporates be doing now with respect to new USD LIBOR contracts? The short answer: stop using LIBOR as soon as practicable for new contracts maturing past 2021. But if that is not possible, make sure appropriate cessation triggers and fallback provisions are included.

Global regulators have recently warned market participants to “stop digging the hole.” In July 2020, both Andrew Bailey, Governor of the Bank of England, and John C. Williams, President of the Federal Reserve Bank of New York, cautioned against continued use of LIBOR-linked contracts. Mr. Bailey indicated that the Bank of England does not expect to see any further GBP LIBOR-linked lending after the end of March 2021, and Mr. Williams said that “it goes without saying that new use of USD LIBOR in financial contracts should stop.” In May 2020, the ARRC recommended that new use of USD LIBOR should stop for floating rate notes by December 31, 2020, and for business loans, derivatives and certain securitizations by June 30, 2021.

Step 4

Plan on How Best to Convert Systems and Amend Legacy Contracts

Global regulators have been aligned in urging marketing participants to prepare for the cessation of LIBOR. There is no guarantee of the publication of LIBOR beyond 2021, and the UK's Financial Conduct Authority ("FCA") has warned that official announcements about its end could come as early as late 2020. Regulators have also been clear that the extraordinary impacts from the COVID-19 pandemic will not delay the transition. Indeed, the FCA has said that the pandemic has not changed the central assumption that companies cannot rely on LIBOR being published after 2021.

A successful transition depends on the careful conversion of existing systems and the amendment of legacy contracts. Managing these changes will take considerable planning and resources. Corporates will therefore have to move with urgency as the transition deadline nears.

NEED TO APPRECIATE TIME IS OF THE ESSENCE

During the middle months of 2020, US banking and market regulators issued various statements communicating the need for market participants—not just banking institutions, but also corporates—to take actionable steps for the transition. A major element of these statements has centered on operational readiness. For example, SEC staff have issued guidance to publicly listed companies and other registrants on the need to consider how certain systems, controls and models may need to be modified to reflect a new reference rate. As the deadline nears, the SEC also has been keenly interested in how companies' external vendors may be impacted by the transition.

Another major focus of regulators' statements has been whether legacy financial contracts have adequate and definitive fallbacks to deal with the end of LIBOR. The urgency for timely contract remediation has taken on importance due to the uncertainty of legislation that would address contracts without fallbacks and that cannot be amended easily to include them. As described more fully in Appendix D, three legislative proposals have emerged, but none are guaranteed to be finalized and none are expected to provide the catch-all "solution" or "fix" that many market participants crave.

- In the UK, the FCA would be given powers to direct the administrator of LIBOR to change the methodology used to compile the benchmark and, in effect, allow for a "synthetic LIBOR" to exist.
- In the US, the ARRC has proposed that New York State law, under which a substantial number of USD LIBOR financial contracts are governed, provide a substitute rate based on SOFR for LIBOR contracts that would otherwise have no workable fallback when LIBOR ceases.
- And in the EU, the EU Commission has proposed providing for the designation of a replacement benchmark for financial contracts that involve an EU "supervised entity" and do not include a "suitable" fallback mechanism.

However, as Michael Held, the Federal Reserve Bank of New York's general counsel, recently cautioned in a speech in September 2020, market participants should "not wait for the state cavalry to ride to [their] rescue."

ENSURE THAT FINANCIAL AND TREASURY STAFF ARE ENGAGED

With no miracles, legislative or otherwise, on the horizon, corporates must plan on converting systems and amending contracts. As an initial matter, corporate treasurers should make sure that financial and treasury functions are represented on a company's working groups related to the transition, including in the development of remediation processes. Staff from these functions are best equipped to identify affected treasury management processes, assess how anticipated cashflows may be impacted by replacement rates, and opine on ways to operationalize proposed changes, among other things. In short, they are a critical component of an effective transition process. A "top down" approach devoid of consultations with key staff will likely lead to timing inefficiencies and informational gaps. Corporate treasurers are uniquely positioned to advocate for the proper engagement of staff with financial and treasury expertise.

UPDATE KEY INTERNAL PROCESSES AND SYSTEMS

The landscape of LIBOR exposures and dependencies for corporates is vast. LIBOR can be referenced in bank loans and other financing arrangements, as well as in inter-company transactions, supplier agreements and even employee benefit plans that invest in LIBOR products. Corporates should not underestimate the operational work that is needed to prepare for using SOFR (or other alternative reference rates) across the diverse array of products and counterparties.

As a starting point, it is necessary to identify all internal systems and key vendor relationships with LIBOR dependencies. This will necessarily require marshaling input from representatives of relevant areas (*e.g.*, treasury, legal, procurement) within the organization. Outside resources also may be helpful in identifying which models or reporting processes are affected. In addition, the ARRC's informational document, titled "Internal Systems & Processes: Transition Aid for SOFR Adoption" (July 8, 2020), should be referenced, as it identifies many common LIBOR-related dependencies that could influence the timing and sequence of market participants' transition activities.

After a comprehensive inventory has been taken, corporates need to convert those processes and systems to reflect SOFR or other alternative reference rates. Although every company will approach this task uniquely, there are two major groupings that corporates should prioritize: treasury processes and treasury infrastructure.

Treasury Processes

Corporate treasurers will need to address a number of treasury processes, including those relating to:

- **Funding and investment management** – The transition away from LIBOR will affect the cost of funding as well as the valuation of loans, derivatives and swaps. Corporate treasurers will need to ensure robust modeling is performed to understand potential effects on the company. From an asset management perspective, particularly for those corporates with surplus funding and investments, the transition away from LIBOR may impact asset performance and the measuring of net asset value.

- **Interest rate and currency risk management** – Corporates should make changes in their interest rate profiles as alternative reference rates are incorporated into financing arrangements. Modeling will also need to be adjusted to reflect the limited historical information tied to RFRs (which, unlike IBORs, are backward-looking) and other alternative reference rates. For those corporates with significant cross-currency exposures, planning will need to account for differing transition timelines across jurisdictions and possibly for a temporary multi-rate scenario in which IBOR-based and other rate-based products co-exist across different currencies.

- **Cash and working capital management** – Corporate treasurers should understand the differences between credit rates and term rates and determine when term rates are preferable for specific cash management, liquidity and cash flow scenarios.

Treasury Infrastructure

Corporate treasurers will need to ensure the conversion of treasury and IT systems relating to, among other areas:

- **Hedge Accounting** – Corporate treasurers need to examine how existing hedge accounting designations may be impacted by the transition. Compliance with applicable FASB relief, including the retention of any necessary documentation regarding accounting elections, must be monitored.

- **Financial Reporting and Payments** – Adequate resources must be deployed to address reporting, payments and other accounting issues that could arise from transitioning to alternative reference rates. Corporate treasurers will be on the front lines for these issues.

- **Cashflow Forecasting** – Internal models, calculations and forecasting tools will need to be modified to reflect alternative reference rates. LIBOR may be used by corporates in several places, including when calculating late payment penalties in contracts with customers or service providers.

DEVELOP AND ADOPT PLANS FOR REPAPERING

Heading into 2021, it is essential that corporates have plans in place for negotiating and executing amendments to implement or clarify a replacement rate. Of course, for derivatives contracts, the solution may lie simply in the adherence to the Protocol (as discussed in Step 2), but significant work remains for other affected contracts and instruments. Corporate treasurers will need to plan for how their teams will function during the LIBOR "repapering" phase, which is fast approaching.

While much of the repapering process will likely be initiated and administered by financial institutions, we recommend that corporates act proactively to minimize the potential for disruption in the year ahead. Corporate treasury teams, in particular, should be developing and adopting plans that are responsive to the following overarching questions:

- **Who should be involved in the repapering process?** Corporate treasurers should put together cross-functional teams for identifying and amending affected contracts and other transactions with financial institutions, suppliers and customers. Decisions will need to be made on who will be negotiating and executing amendments as well as how outside advisors and technology tools will be used, if at all.

- **Where should the lines of authority be drawn for key tasks?** Corporates will have different approaches as to where the transition is principally managed (for example, some may have an internal program office or "change management" function take on this role, whereas others will look to the corporate treasury function or legal function for principal leadership). However, in all cases, there should be clear lines of authority with respect to amendment negotiation tasks and execution decisions. Any plan should identify which business unit/person is responsible for agreeing on fallback language or replacement rate provisions and when "sign offs" from the corporate treasury or legal functions should be obtained. The development of negotiation parameters and escalation and approval protocols is also important.

- **What contracts and instruments are "in play"?** As discussed, the scoping of relevant contracts and instruments is a gating item for an effective repapering process. The corporate treasury function will be critical not only in identifying financial exposures and counterparties, but in making assessments as to the relative ease of remediation and developing strategies for communicating with counterparties.

- **When should key tasks and milestones be completed?** The ARRC has advised market participants to act on the assumption that LIBOR will end as of December 31, 2021. However, that date should not be regarded as the deadline for key tasks and milestones because there is always the risk that the FCA could make a "pre-cessation" to the effect that LIBOR is no longer representative of the interbank lending rate. Regardless, the steps that need to be taken to negotiate and execute amendments will take considerable time because of the sheer number of contracts and counterparties involved and the analyses that will invariably need to be undertaken on economic, accounting, legal and other issues. Market expectations and "best practices" communicated by various regulators also must be considered when setting deadlines for contract review, pre-negotiation communications, fallback language development, negotiation and execution and other tasks.

Corporate treasurers are critical to ensuring operational readiness, which will entail enhancements or modifications to deep-rooted processes and systems, including risk and valuation models.

Step 5

Prepare for Communications and Regulatory Engagement

As corporates navigate the LIBOR transition, they must anticipate the informational needs of their boards of directors and senior management, financial institution counterparties, and regulators and investors. Effective communication and engagement are critical as the discontinuation of LIBOR draws closer. Corporate treasurers and other finance leadership are on the frontlines of explaining transition-related changes, costs, risks and other considerations.

BOARD AND SENIOR MANAGEMENT COMMUNICATIONS

The transition represents a market-driven change that commentators have generally described as requiring Herculean tasks of analyzing and remediating contracts and coordinating among counterparties. Boards and senior management will expect periodic updates on the governance and progress of transition programs and related work. Corporate treasurers are integral to ensuring that directors and senior management are not only briefed on the nature and pace of changes but understand those transition-related tasks meriting enhanced attention or resources. Market regulators, particularly the SEC, have been keenly interested in how companies are managing financial and non-financial transition risks, how alternative rates are being assessed, and on companies' plans and processes for operational readiness. Corporate treasurers therefore must be able to respond with precision to questions on these points from directors and senior management as well as from other functions (*e.g.*, legal, risk, technology) and business units.

FINANCIAL INSTITUTION COUNTERPARTIES

Corporate treasurers and their staff should expect to take an active role in assessing, and developing responses to, communications from these financial institution counterparties. By this point in the transition, nearly all the major global banks and financial institutions have initiated customer engagement programs to educate their clients (corporate borrowers are, of course, clients) on the transition's purpose and highlight key issues and risks. These programs have generally entailed a mix of generic website-based information and/or holding statements on the LIBOR transition and answers to frequently asked questions. More proactive outreach from financial institutions has included client webinars and briefings and, in some cases, direct conversations between clients and relationships managers.

Notwithstanding these communication efforts, there is increased urgency by many corporates for "solutions," and for banks and financial institutions to come to them—their clients—with solutions. As the transition draws closer, corporates need to consider effective ways to meaningfully engage with their banking and financial institution counterparties. Corporate treasurers should, in coordination with appropriate business units:

- identify relevant relationship managers for the financial institutions that are tied to a company's most material LIBOR exposures;
- confirm the corporate or business strategy for each relationship and how best to remediate or address each particular LIBOR exposure (based on work and analyses discussed earlier in this guide); and
- develop a communications strategy for each relationship, with information on staff responsible for significant tasks (*e.g.*, research, drafting of talking points or questionnaires) and the timing for initial outreach and subsequent engagements.

With these points in mind, corporates should not underestimate the value of acting proactively. Conversations—perhaps, tough conversations—may need to be had. Corporates may wish to ask about a relationship bank's plans for legacy loans and other IBOR-linked products that will mature beyond 2021. Relatedly, if corporates are still planning on borrowings linked to LIBOR or another IBOR, then questions should be asked of the relevant lenders as to how loan agreements and related documentation will change to an alternative rate ahead of the cessation. Not least of all, corporates should consider asking their relationship banks about the timing for offering loans and other products that are linked to new RFRs.

REGULATORS AND INVESTORS

Corporate treasurers and their staff also need to be mindful of their role in supporting a company's relationships with its regulators and investors. The LIBOR transition is of interest to many types of regulators and standard-setting bodies. Even a non-complex business organization may need to make several different types of regulatory disclosures and submissions that contain information regarding its transition. The corporate treasury function should be aware of market practices (including any "best practices") and regulatory expectations relating to the transition and the types of information that may be requested or required by regulators or from other internal staff (*e.g.*, legal, compliance, risk) who are responsible for preparing disclosures or other reports. Clear communication on a company's plan for its transition is also important for maintaining investor confidence.

High-Level Checklist of Key Tasks

The LIBOR transition is a monumental undertaking for the financial system and its market participants. Because LIBOR is deeply embedded in the financial ecosystem, a broad set of financial products and market segments will be impacted by its cessation. Corporates are not shielded from this change. They must properly plan, mobilize and execute a plan for the transition. This high-level checklist was developed to provide a general framework for consideration.

INITIAL GOVERNANCE AND PLANNING RELATED TASKS

- ☐ **Establish Program Governance:** Implement a robust governance framework with accountable senior executives to oversee the delivery and coordination of the company's enterprise-wide LIBOR transition program.
- ☐ **Develop Project Management Plan:** Establish an enterprise-wide plan across functions and businesses to evaluate and mitigate the risks associated with the transition, with specific considerations for unique product and client exposures.

SCOPING AND ANALYSIS RELATED TASKS

- ☐ **Contract Identification and Collection:** Identify and collect all affected contracts and financial instruments that reference LIBOR and have maturities beyond 2021.
- ☐ **Identify and Validate Exposure:** Quantify and develop a flexible approach to monitor LIBOR-linked assets and exposures through the transition period.

REMEDIATION, REPAPERING AND NEGOTIATION RELATED TASKS

- ☐ **Assess Contractual Remediation Impact and Design Plan:** Understand the financial, business and legal impacts resulting from transitioning through fallbacks, and plan mechanisms for implementing those fallback provisions through an organized repapering process.
- ☐ **ISDA Protocol Adherence:** Consider adhering to the ISDA Protocol for affected derivatives and other contracts (*e.g.*, repo master agreements, security loan master agreements, FX master agreements). Analyze the implications of how the ISDA Protocol may impact more bespoke products and whether, in some cases, certain definitions and other terms may need to be amended to better suit a company's needs.
- ☐ **Develop Product and Portfolio Strategy:** Develop strategy for redesigning or transitioning the existing portfolio of LIBOR products, where needed, including consideration of using new products based on SOFR or other RFRs. For portfolios tied to LIBOR as a benchmark or investment guideline, understand implications for the forward portfolio and transition where appropriate.
- ☐ **Use RFRs:** Aim to use SOFR or other RFRs in new contracts wherever possible. If not, then ensure that new contracts incorporate adequate fallbacks.
- ☐ **Develop Contract Negotiation Plan:** Develop a plan governing contract negotiations, including an articulation of policy preferences, escalation procedures and decision parameters.

OPERATIONS, COMMUNICATIONS, REPORTING AND OTHER TASKS

- ☐ **Develop Operational and Technology Readiness Plan:** Develop a plan to address the operating model, data and technology implications required as a result of LIBOR transition, including with respect to vendors.
- ☐ **Implement Communication Strategy:** Develop and implement an enterprise-wide strategy with clear objectives to engage, communicate and increase levels of education with impacted internal and external stakeholders. In particular, develop strategy for proactively engaging with financial institution counterparties, including making contact with counterparties to discuss how existing contracts may be affected and what steps firms may need to take to prepare for use of alternative rates.
- ☐ **Accounting and Reporting:** Determine accounting, reporting, and net asset value considerations.
- ☐ **Taxation and Regulation:** Determine tax and regulatory considerations.

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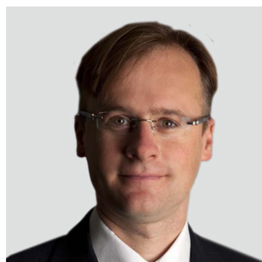

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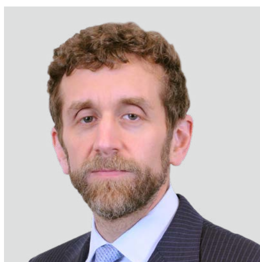

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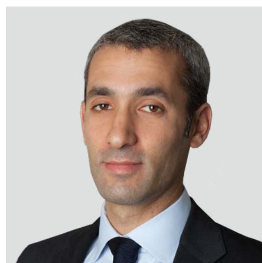

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