INSIGHT
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COVID-19 and the Early Impacts on LIBOR Transitions

What has and has not changed for LIBOR transition efforts since the COVID-19 induced economic downturn? What are some potential steps LIBOR transition teams should consider in the upcoming weeks?

Sia Partners' LIBOR Services Team continues to remain engaged in the market related to LIBOR transition efforts through the disruption of COVID-19. As market conditions and responses from policymakers evolve, Sia Partners will continue to provide insights on the impact to the transition.

COVID-19 and the Impact on LIBOR Transitions

The unprecedented developments over the past month lead by the spread of COVID-19 and the subsequent severe economic downturn have resulted in unseen challenges to the global infrastructure and for many their own physical well-being. Within that broader set of severe day to day consequences, financial entities of all types face parallel problems of ensuring the continued safety and soundness of their operations, maintenance of sufficient capital, regulatory compliance and serving their clients. Sia Partners is speaking to many of those issues on other posts, and today addressing how institutions are focused on the transition from LIBOR to other agreed-upon reference rates.

Over the past several years, Sia Partners has continued ongoing discussions and proprietary efforts with financial entities worldwide who are effectuating plans for their LIBOR transition. This included our LIBOR Global Benchmarking Study and updates shared with dozens of institutions and third parties through the first quarter this year. Through the first quarter, institutions were continuing their progress through their execution of comprehensive, enterprise-wide transition plans across key transition activities. Institutions remained focused on the management of detailed lines of business or product timelines, enhancement of governance frameworks and increased inclusion of their second lines of defense in those efforts as liquidity in key financial markets was slowly continuing to build across the majority global Alternative Reference Rates (ARRs).

The transition was and remains an extremely complex market challenge on a unique scale that impacts the complete spectrum of financial market participants, which makes the industry transition off LIBOR by the end of 2021 a continued challenge. There were defined leaders, fast-followers and some institutions that had yet initiated those efforts. However, progress was being made for most at a steady pace and the transition was emerging as a key theme for financial institutions in Q1 2020.

What hasn't changed – The Cessation Date

The Financial Conduct Authority (FCA) on March 25, 2020, re-affirmed in their statement on the impact of the coronavirus on firms' LIBOR transition plans, that the target cessation date for all firms to meet remains the end of 2021.

> ***Financial Conduct Authority***
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> *The central assumption that firms cannot rely on LIBOR being published after the end of 2021 has not changed and should remain the target date for all firms to meet. The transition from LIBOR remains an essential task that will strengthen the global financial system.*
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> *-Statement on March 25, 2020, Impact of the coronavirus on firms' LIBOR transition plans*

Speculation aside, the FCA's statement highlights its current position to proceed forward with its planned cessation date. Despite the FCA's statement on the cessation date, a lot has changed specific to LIBOR transition efforts. The following section examines some of those changes.

What has changed – Almost everything else (at least in the short term)

Market Conditions

The immediacy and severity of the financial market and economic disruption caused by the pandemic has been felt around the globe. Pressure has quickly mounted in many key functions of the financial markets including the permanence of volatility across interest rate, equity, oil, and almost all underlying markets and economic sector/indicators. As a result, Central Banks, including the U.S. Federal Reserve, have stepped in with aggressive responses to support and maintain the safety and soundness of the markets they regulate. Even with those efforts and additional direct steps to alleviate pressure on key components of normally thriving financial markets, e.g., open-ended quantitative easing of debt securities, re-launching the Money Market Mutual Fund Facility (MMLF), and vast expansion of repo market operations, the impact of market disruption and illiquidity in these markets is going to be substantial. This, in turn, means that it will impact, at least in the near-term, the ability and willingness of some institutions to begin earnest shifts toward other agreed-upon reference rates.

Clients and Counterparties

Through the first quarter, client communication and enhancement of outreach and remediation strategies were emerging as the key focus for transition teams. Organizations were engaging clients in varying levels of outreach with the largest banking institutions beginning to initiate directly with clients while enhancing their internal approaches to managing the risks associated with client communication at scale, i.e., conduct, litigation, regulatory, financial and operational. Most other participants we had spoken to had not taken similarly aggressive steps with the majority of their clients.

The impact of the current economic downturn will impact clients and counterparties beyond the resourcing and organizational elements we have described below. From an economic perspective, client positioning and associated contracts will change, the potential of forbearances, defaults or restructurings complicate how institutions should assess and/or redefine remediation and communications strategies at an organization and line of business level.

Finally, of particular relevance for corporate or institutional clients, counterparties or investors, it is unclear how the impact of public health restrictions impact the ability for effective communication and renegotiation of documents (delays in-person meetings, etc.).

Operations and Resourcing

With the widespread implementation of business continuity plans, Sia Partners is engaging our clients throughout the world on our LIBOR and non-LIBOR engagements in a virtual manner, as institutions have quickly shifted to a new operational and resourcing model to support and protect the safety of personnel and continued essential operations. The vast majority of our clients are now relying on a remote working arrangement for a portion if not all of their workforce. In addition, institutions are currently shifting the activities and allocations of resources and personnel to meet the new demands on BAU processes due to the increased volume of transactions resulting from market disruption.

Specific to, but not exclusive to the transition, we have observed disruption in onboarding and hiring capabilities. These disruptions are, in the short-term, impacting the ability of firms to ramp up their support teams and fully engage software or other third-party vendors. In addition, Clients have described pressure around maintaining historical manual documentation processes under BCP and remote work arrangements.

These operational disruptions, as well as the market and client impacts, will impact the prioritization of transition tasks and near term milestones as institutions grapple with the fallout from the pandemic. The re-prioritization of needs and resources is likely to only heighten challenges for certain institutions to meet near term industry milestones. As the FCA acknowledged, the disruptions are likely to impact institutions on a product by product basis, interim industry-driven transition milestones, and forthcoming regulatory efforts.

While there is the possibility of near term relief for certain industry milestones on a regulator by regulator basis, transition teams should not depend on general statements in determining next steps as regulators have already started to depart on approaches specific to the handling of non-LIBOR related initiatives during the downturn, e.g., differing approaches between the U.S. Federal Reserves and FCA's treatment for upcoming stress tests.

While not exhaustive, the steps highlighted below provide suggestions on steps LIBOR transition teams should consider undertaking in the coming weeks.

Financial Conduct Authority

Particularly in segments of the UK market that have made less progress in transition and are therefore still more reliant on LIBOR, such as the loan market, it is likely to affect some of the interim transition milestones.

-Statement on March 25, 2020, Impact of the coronavirus on firms' LIBOR transition plans

What are some steps for LIBOR transition teams in the coming weeks?

Monitor

In line with ARRC's recommended guidelines, institutions should continue to proactively monitor evolving and/or shifting external industry and/or regulatory developments. The scope, length, and severity of the economic and market disruption are unknown. Industry participants will be impacted to varying degrees. The responses from regulators and policymakers as well as priorities will evolve, e.g., other existing regulatory initiatives (CCAR, CECIL, FRTB, etc.) and global efforts which will require their immediate attention before the LIBOR transition. As a result, transition teams will need to actively monitor for updates and changes.

Maintain

Transition teams should, given the circumstances and extenuating developments, remain engaged and committed to defined project plans and key transition activities/milestones. Where practical and within a balance of their own firms capacities, organization leadership and transition teams should look to avoid pausing their efforts or enacting major transition changes such as budgetary pullbacks or significant resource reductions, unless necessary or after reassessment.

Reassess

As clarity begins to emerge surrounding the impact of the economic downturn and market volatility, transition teams should engage in a detailed reassessment of their transition effort strategies (new product, customer communication, legacy product remediation, etc.), timelines and milestones, internal and external dependencies, and resource allocation to ensure the transition effort is still aligned with organizational, industry, regulatory and client needs and demands.

Redefine

Where necessary, based on the findings of the reassessment, transition teams may need to redefine certain activities or workstreams within their transition plan and approach.

Redefine Example

Transition teams may need to redefine segments of customer communication or remediation prioritization or strategies as the result of evolving regulatory changes and requirements as policymakers work to mitigate the fallout from the pandemic, e.g., state-level mandated forbearance relief.

Reassess Example

Transition teams may need to consider reassessment of prior documentation inventory/analysis exercises and risk assessments for product portfolios impacted by the economic and market disruption to confirm documentation changes specific to applicable triggers, client positions, etc.

Reallocate

Where necessary and based on the findings of the reassessment, transition teams should reallocate or redefine resourcing strategies (capital, budgetary and personnel) to meet new strategies, timelines or prioritizations, e.g., giving consideration to supplementing hard-hit transition activities with variable/flexible workforces.

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