BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

SR 21-7

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TO THE OFFICER IN CHARGE OF SUPERVISION AND APPROPRIATE SUPERVISORY AND EXAMINATION STAFF AT EACH FEDERAL RESERVE BANK AND INSTITUTIONS SUPERVISED BY THE FEDERAL RESERVE

SUBJECT: Assessing Supervised Institutions' Plans to Transition Away from the Use of the LIBOR

Applicability: This letter is relevant to all firms supervised by the Federal Reserve.

As a follow-up to the issuance of the Interagency Statement on LIBOR Transition[1] on November 30, 2020, the Federal Reserve is issuing the attached guidance[2,3] to assist examiners in assessing supervised firms' progress in preparing for the transition. The interagency statement notes that entering into new contracts that reference LIBOR after December 31, 2021 would create safety and soundness risks; it encourages supervised firms to cease entering into such contracts as soon as practicable.[4] The extension of certain LIBOR tenors until June 30, 2023 will allow some existing LIBOR exposures to mature naturally.

Examiners should review supervised firms' planning for, and progress in, moving away from LIBOR during examinations and other supervisory activities in 2021. Supervised firms should demonstrate progress towards moving away from referencing LIBOR in new products. The attachments outline the factors that examiners should consider in assessing six key aspects of transition efforts: (1) transition planning; (2) financial exposure measurement and risk assessment; (3) operational preparedness and controls; (4) legal contract preparedness; (5) communication; and (6) oversight. Separate attachments are included for institutions with less than $100 billion in total consolidated assets (which generally have less material and less complex LIBOR exposures) and those with $100 billion or more in total consolidated assets

[1] https://www.federalreserve.gov/supervisionreg/srletters/SR2027.htm
[2] Examiner Guidance for Assessing LIBOR Transition Efforts at Firms with Less Than $100 Billion in Total Consolidated Assets Supervised by the Federal Reserve
[3] Examiner Guidance for Assessing LIBOR Transition Efforts at Supervised Firms with $100 Billion or More in Total Consolidated Assets
[4] The Alternative Reference Rates Committee (ARRC) has published "best practices" that provide various deadlines for when firms should cease entering into contracts that reference LIBOR. For example, the ARRC "best practices" provide that no business loans using USD LIBOR and maturing after 2021 should be originated after June 30, 2021. Examiners should not rely on deadlines in the ARRC's "best practices", but rather focus on the ability of supervised firms to cease entering into new contracts that reference LIBOR by December 31, 2021, consistent with the Interagency Statement on LIBOR Transition.

(which generally have more significant and complex LIBOR exposures and should develop more detailed transition plans).

Supervised firms that are not making adequate progress in transitioning away from LIBOR could create safety and soundness risks for themselves and for the financial system. Accordingly, examiners should consider issuing supervisory findings and other supervisory actions if a firm is not ready to stop issuing LIBOR-based contracts by December 31, 2021.

In addition to examination work, the Federal Reserve is working with both domestic and foreign supervisors, sharing information and discussing LIBOR transition preparedness in supervisory colleges and other forums (e.g., the Financial Stability Board, the Basel Committee on Banking Supervision) as the global effort to transition away from LIBOR by December 31, 2021 continues.

Reserve Banks should distribute this letter to the supervised firms in their districts, as well as to appropriate supervisory and examination staff.

Supervised firms with specific questions concerning their examination and supervisory activities should direct these questions to their Reserve Bank point of contact or the examiner in charge. In addition, supervised firms may send questions via the Board's public website.[5]

Michael S. Gibson
Director
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Attachments:

1. *Examiner Guidance for Assessing LIBOR Transition Efforts at Firms with Less Than $100 Billion in Total Consolidated Assets Supervised by the Federal Reserve*
2. *Examiner Guidance for Assessing LIBOR Transition Efforts at Supervised Firms with $100 Billion or More in Total Consolidated Assets*

[5] See http://www.federalreserve.gov/apps/contactus/feedback.aspx.

Examiner Guidance for Assessing LIBOR Transition Efforts at Firms with Less Than $100 Billion in Total Consolidated Assets Supervised by the Federal Reserve

During regularly scheduled Federal Reserve-led examinations of holding companies, state member banks and U.S. branches and agencies of foreign banks for 2021, examiners should evaluate preparedness for the LIBOR transition based on the considerations described below. Examiners should document findings regarding LIBOR preparedness in workpapers and summarize those findings, along with any recommendations for board or management attention, in examination reports.

Examination work should be tailored to the size and complexity of the LIBOR exposures. For most firms with less than $100 billion in total consolidated assets, exposures to LIBOR are modest and reviews should be narrowly focused while using the considerations listed below as a guide when planning examination work. LIBOR exposures may be significant at larger firms and foreign banking organizations and, as a result, require more supervisory scrutiny—particularly for firms with more capital markets activities or broker-dealer affiliates.

If necessary, examiners should conduct work at a holding company or its nonbank subsidiary(s) to assess the overall preparedness of the consolidated organization.[1] To the fullest extent possible, examiners should rely on assessments completed by primary supervisors of lead depository institutions[2] in their assessment of a consolidated organization's LIBOR preparedness.[3]

Examiners should invite their state supervisory counterparts to participate in any targeted examinations and, if requested, should assist in assessing preparedness during state-led examinations. Examiners should also collaborate with other federal regulators as appropriate.

Examination considerations:

A supervised firm with exposure to LIBOR and less than $100 billion in total assets[4] should prepare for the LIBOR transition with respect to six key areas:

1. <u>Transition planning:</u> The firm should plan to transition away from LIBOR-based financial products. The detail and scope of transition planning should be commensurate with the firm's LIBOR exposures. Institutions with complex products or multiple

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[1] SR Letter 13-21, Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less, provides guidance regarding inspections of holding companies with $10 billion or less in total consolidated assets.
[2] 12 CFR 225.2(h).
[3] SR Letter 16-4, Relying on the Work of the Regulators of the Subsidiary Insured Depository Institution(s) of Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of Less than $50 Billion. Examiners should also rely, to the fullest extent possible, on assessments of LIBOR preparedness completed by the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), or State regulatory agencies in the case of subsidiaries that are functionally regulated subsidiaries under the Bank Holding Company Act. 12 U.S.C. 1844(c)(5).
[4] This includes foreign banking organizations (FBOs) with consolidated U.S. assets of less than $100 billion.

product lines tied to LIBOR should maintain plans with greater detail and a project roadmap that defines transition timelines and milestones.

2. Financial exposure measurement and risk assessment: The firm should accurately measure its financial exposures to LIBOR and report the exposure to senior management.
3. Operational preparedness and risk control: The firm should identify any internal and vendor-provided systems and models that use or require LIBOR as an input and, if possible, make necessary adjustments to maintain smooth operation of those systems and models ahead of the cessation of LIBOR. The firm should establish a contingency plan in the event that its service provider is unable to deliver a solution in a timely manner.
4. Legal contract preparedness: The firm should identify contracts that reference LIBOR. New LIBOR-based contracts entered into before December 31, 2021 should have robust fallback language that includes a clearly defined alternative reference rate after LIBOR is no longer available.[5] The firm's transition plans should address how the firm will determine the impact of LIBOR's cessation on its contracts and the steps the firm will take to modify these contracts prior to LIBOR's cessation.
5. Communication: Commensurate with its exposure to LIBOR, the firm should communicate to its counterparties, clients, consumers, and internal stakeholders about the LIBOR transition. The firm should ensure compliance with requirements of the Truth in Lending Act and other applicable laws and regulations and with the prohibition on engaging in Unfair or Deceptive Acts or Practices.
6. Oversight: The firm should provide the plan (as described in 1) to applicable management,[6] and provide regular status updates to senior management.

Examiners should review the plan of a supervised firm to confirm that the firm is able to identify and understand their LIBOR exposures. Examiners should discuss with a firm its plans for addressing LIBOR exposures and evaluate whether the firm has a plan in place to transition away from entering into new LIBOR based financial contracts after December 31, 2021.

[5] As noted in SR Letter 20-25, a firm may use any reference rate for its loans that the firm determines to be appropriate for its funding model and customer needs. Fallback language may identify a clear mechanism for selecting an alternative rate if the parties believe that an appropriate alternative rate is not currently available.
[6] For a foreign bank's U.S. operations this could include the country head, U.S. executive, branch manager, or other leadership function.

Examiner Guidance for Assessing LIBOR Transition Efforts at Supervised Firms with $100 Billion or More in Total Consolidated Assets.

As part of continuous monitoring of large firms, examiners should evaluate preparedness for the LIBOR transition based on the considerations described below. Examiners should document findings regarding LIBOR preparedness in workpapers and summarize those findings, along with any recommendations for board or management attention, in examination reports.

Examiners should invite their state and federal supervisory counterparts to participate in monitoring meetings and, if requested, should assist in assessing preparedness during examinations led by other supervisory agencies. If necessary, examiners should conduct work at a holding company or its nonbank subsidiary(s) to assess the overall preparedness of the consolidated organization. To the fullest extent possible, examiners should rely on assessments completed by primary supervisors of lead depository institutions[1] in their assessment of a consolidated organization's LIBOR preparedness.[2]

Large holding companies are likely to have significant exposure to LIBOR and examination work may be needed to assess their readiness for the transition. If assessments suggest a firm is lagging in its LIBOR preparedness or may not be able to address its exposures in a timely manner, examiners should plan to conduct, or request that the primary supervisor conduct, additional targeted reviews for the organization before the end of 2021.

Examination considerations:

A supervised firm with exposure to LIBOR and $100 billion or more in total consolidated assets[3] should prepare for the LIBOR transition with respect to six key areas:

1. Transition plan: The firm should have a LIBOR transition plan that includes a governance structure that clearly defines roles and responsibilities needed to execute the plan and a project roadmap with defined timelines and milestones.
    a. The plan should align with the firm's risk management function across business and product lines and cover all geographies relevant to the firm.
    b. The governance structure specified in the plan should designate a specific group (existing or new) to oversee the plan with appropriate senior-level oversight,

[1] 12 CFR 225.2(h)
[2] Examiners should also rely, to the fullest extent possible, on assessments of LIBOR preparedness completed by the SEC, CFTC, or State regulatory agencies in the case of subsidiaries that are functionally regulated subsidiaries under the Bank Holding Company Act. 12 U.S.C. 1844(c)(5).
[3] This includes FBOs with more than $100 billion in consolidated U.S. assets.

including involvement from affected business lines and the funds management (e.g., treasury, asset-liability committee), risk management and audit functions.

   c. The plan should address how the firm will identify and address both financial impacts and operational gaps in order to complete the plan.
   d. The firm should define, and identify within the plan, contingencies that could impact the success of the plan or of components of the plan.
   e. Senior leadership of the firm should provide appropriate budget and personnel resources to support implementation of the plan and to avoid timeline delays.
   f. The plan should address how the oversight and independent review/internal audit functions will effectively review LIBOR transition project status, reporting, timelines, and milestones.

2. <u>Financial exposure measurement and risk assessment:</u> The firm should accurately measure its financial exposures to LIBOR. Exposure measurement should include any financial product that references LIBOR and may include, but is not limited to, investments, derivatives, and loans.
   a. Exposure measurement should identify exposures by product, counterparty, and business line. The firm should identify what exposures are proprietary or custodial.
   b. The firm should have adequate controls and review processes in place to maintain a reasonable level of reporting accuracy and completeness.
   c. Exposure measurement reporting should be frequent, for example quarterly.
   d. The firm should have the ability to identify the proportion of its LIBOR exposure that will run off before the relevant tenor ceases (either December 31, 2021 or June 30, 2023). The firm should be able to highlight valuation and hedging challenges resulting from switching from LIBOR to an alternative rate.
   e. Foreign firms should measure LIBOR exposures booked and/or managed within U.S. operations. Foreign firms should also be able to quantify exposures within the U.S. operations in comparison to the LIBOR exposure of the consolidated foreign parent.

3. <u>Operational preparedness and risk control:</u> The firm should identify all internal and vendor-provided systems and models that use or require LIBOR as an input and make

necessary adjustments to provide smooth operation of those systems and models ahead of cessation of LIBOR.

   a. The firm should have a complete inventory of affected systems and models, ranked by criticality or significance.
   b. Where the firm uses vendor-provided systems, the firm should confirm with the service provider that necessary updates will be available for testing and implementation before December 31, 2021.
   c. The firm should establish a contingency plan in the event that a service provider is unable to deliver a solution in a timely manner.
   d. Any changes made by the firm to models should adhere to sound model risk management practices as described in SR Letter 11-7, and progress reporting should be included in the firm's transition plan.

4. <u>Legal contract preparedness:</u> The firm should identify all contracts that reference LIBOR and refrain from entering into contracts without fallback language.
   a. The firm should identify contracts that lack fallback language that defines an alternative reference rate after LIBOR is no longer available.
   b. For contracts that lack adequate fallback language and will mature after the relevant tenor ceases (either December 31, 2021 or June 30, 2023), the firm's transition project plans should address how the firm will determine the impact of LIBOR's cessation on these contracts and the steps the firm will take to address these contracts prior to LIBOR's cessation. Given that one objective of the extension of certain LIBOR tenors was to allow more time for the development of transition plans for such contracts, examiners should recognize that these plans will become more detailed as the relevant cessation date approaches. Firms should show credible progress in developing their plans during this period, and should have complete plans well before the cessation date of any particular tenor (for example, six months).
   c. If a firm is a major user of derivatives, it should consider adhering to the International Swaps and Derivatives Association (ISDA) IBOR Fallback Protocol and IBOR Fallback Supplement (together, the Protocol) to implement robust fallbacks for legacy and new derivative contracts.[4] The firm should also track

[4] SR Letter 20-22 ISDA IBOR Fallback Protocol and IBOR Fallback Supplement

customers who will not adopt the Protocol and take action to mitigate associated risks.

d. New LIBOR-based contracts entered into before December 31, 2021 should have robust fallback language that includes a clearly defined alternative reference rate after LIBOR is no longer available.[5]

e. Any firm that invests in syndicated loans should work with its relevant agent banks to ensure that the agent banks appropriately address fallback language in syndicated loan contracts.

5. Communication: The firm should communicate to its counterparties, clients, consumers, and internal stakeholders about the LIBOR transition. The firm should ensure compliance with requirements of the Truth in Lending Act and other applicable laws and regulations and with the prohibition on engaging in Unfair or Deceptive Acts or Practices.
   a. The firm should implement training for employees to inform all relevant staff of the LIBOR transition, how the LIBOR transition will affect staff work, and, if applicable, how staff are to communicate the implications of the LIBOR transition externally.
   b. The firms should provide regular updates to key stakeholders during the transition period covered by the plan.

6. Oversight: The group designated to oversee the transition plan (as described in 1.b), should ensure timely updates to senior management and the board of directors.
   a. The group should provide regular updates on plan progress and alerts regarding any significant/material delays in plan progress, including gaps or obstacles that could impede plan completion. Any reporting should be timely and include financial exposures as well as inventories of legal contracts referencing LIBOR.
   b. If the firm is a foreign entity with U.S. total assets over $100 billion, the firm should provide updates on LIBOR transition efforts to the U.S. Chief Risk Officer and the U.S. Risk Committee.
   c. The board should hold senior management accountable for effectively implementing the firm's plan.

Examiners should review the internal plans of supervised firms to ensure that firms identify and mitigate risks related to their LIBOR exposures. Examiners should discuss with the firm its plans for addressing LIBOR exposures and evaluate whether the firm has a plan in place to transition away from entering into new LIBOR-based financial contracts after December 31, 2021.

[5] As noted in SR Letter 20-25, a firm may use any reference rate for its loans that the firm determines to be appropriate for its funding model and customer needs. Fallback language may identify a clear mechanism for selecting an alternative rate if the parties believe that an appropriate alternative rate is not currently available.