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April 14, 2021

The Honorable Brad Sherman
Chairman
Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets
U.S. House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets
U.S. House of Representatives
Washington, DC 20515

Re: Subcommittee Hearing “The End of LIBOR: Transitioning to an Alternative Interest Rate Calculation for Mortgages, Student Loans, Business Borrowing, and Other Financial Products”

Dear Chairman Sherman and Ranking Member Huizenga:

We are writing on behalf of the Association for Financial Professionals, the National Association of Corporate Treasurers, and the U.S. Chamber of Commerce’s Center for Capital Markets Competitiveness to provide our views to you in advance of your upcoming hearing on the LIBOR transition. Our respective organizations are members of the Alternative Reference Rates Committee (ARRC), a group convened by the Federal Reserve Board of Governors and the Federal Reserve Bank of New York to ensure a successful transition from U.S. dollar LIBOR to a more robust reference rate. We further participate in the ARRC’s Nonfinancial Corporates Working Group, which includes approximately one hundred large and small Main Street companies from across the U.S.

As this Subcommittee considers the LIBOR transition, we would like to share with you the various challenges surrounding the transition to the community of nonfinancial corporates (NFCs) and encourage you to support legislation that would provide a benchmark replacement rate for contracts that currently reference LIBOR. Given the challenges facing NFCs as they navigate the LIBOR transition, it is important to minimize the legal uncertainty and adverse economic impacts to NFCs in the event that a contract does not contain fallback provisions for a LIBOR replacement rate.

LIBOR Transition

For several decades, the London Interbank Offered Rate (LIBOR), regulated by the United Kingdom's Financial Conduct Authority (FCA), has been the benchmark reference rate at which major banks will lend to one another for short-term loans. Following the 2008 financial crisis, a decision was made to transition away from LIBOR toward a replacement reference rate more closely based on U.S. Treasury market transactions. The ARRC has identified the Secured Overnight Financing Rate (SOFR) as the rate that represents the best practice for use in loans, certain new U.S. dollar derivatives, and other financial contracts. The ARRC's recommendation is based in part on remediating the volatility and unreliability of LIBOR where \$500 billion of underlying inter-bank transactions support the interest rate settings on \$200 trillion of loans and other financial instruments.¹ This orders-of-magnitude difference becomes even more unbalanced for LIBOR and other credit-sensitive rates during times of financial market stress when transaction volumes shrink while rates spike up, causing a spiral of increasing unreliability for those rates.

The markets had been warned that all LIBOR rates were expected to end after 2021. However, in March 2021, the FCA announced that while certain U.S. dollar LIBOR rates, such as the two-month quotation, would cease as of year-end 2021, other maturities very commonly used in financial instruments and contracts, including those for one, three, and six months, would continue to be quoted until June 30, 2023, allowing some additional time for U.S. dollar instruments and contracts to be amended to provide alternate references to SOFR.

Transition Impact to NFCs

The transition away from LIBOR is important because the potential disruption or cessation of LIBOR poses a financial stability risk as well as a risk to the individual firms with LIBOR exposures.² Main Street borrowers need to be no worse off when SOFR becomes fully adopted. Otherwise, borrowers and issuers will bear higher interest and financing costs, which could ultimately result in cost-cutting elsewhere, including potential job cuts.

Most financial market participants are aware that LIBOR's administrator, the ICE Benchmark Administration, will cease publishing the LIBOR rate in the near future, forcing them to transition to a replacement rate. Nearly \$200 trillion of financial contracts reference U.S. dollar LIBOR. These contracts must be amended through negotiations by the counterparties or there will be risk of a significant disruption in our financial system and the overall economy. Moreover, as Main Street companies navigate the transition for both legacy contracts and new loans, they face considerable operational, technological, accounting, tax, and legal challenges.

Specifically, NFCs strive to maintain close relationships with the banks they rely on to fund their operations. Many NFCs currently struggle in obtaining from their lenders specific proposals and processes for how their loan agreements will be amended and the mechanics of how the ARRC's recommended SOFR rate will substitute for LIBOR. The consistent feedback we have received from our working group's members and from a survey of their recent interactions with their bankers

¹ Second Report of the Alternative Reference Rates Committee, March 2018,

<https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report>

² Alternative Reference Rates Committee, "Transition from LIBOR," <https://www.newyorkfed.org/arrc/sofr-transition>

has shown that fully two-thirds have been unable to receive detailed proposals or timelines for implementation from their bankers. Please refer to Appendix A for more details on responses from survey participants.

As you may be aware, Prudential Banking Regulators³ recently warned that banks should cease making new LIBOR loans by year-end 2021; however, many banks are not yet offering SOFR-based loans even to large, well-capitalized NFCs. Several companies participating in our Nonfinancial Corporates Working Group have reported that while their banks have provided fallback provisions against the future cessation of LIBOR, they are unable to negotiate current access to SOFR borrowings, even with large multi-year credit agreements nearing renewal.

We understand that banks are also facing considerable challenges in preparing for the LIBOR transition. Yet, we are concerned that by the time the banks have fully prepared transition materials and processes, the NFCs awaiting that information would have little to no time to rework contracts, even with the extension provided by the FCA. It will be especially difficult for small- to medium-sized Main Street companies with smaller staffing to handle these complex issues while continuing to focus on their day-to-day business operations and recovery from the effects of COVID-19.

Another area of concern for NFCs regards those financings where they have limited contact with the counterparties, unlike their traditional relationship with bank lenders. Examples of such financings include:

- Term loans often syndicated by the arrangers among institutional investors;
- Floating rate notes sold to and freely traded among institutional investors; and
- Asset securitizations financing NFCs' purchases of business inventories and their customers' receivables, which often involve underlying loans traded among institutional investors.

These widely used financial instruments in almost all cases require the consent of all lenders for any amendment affecting the interest rate, such as would be necessary to reference SOFR instead of LIBOR. As you can imagine, renegotiating all such contracts would be an onerous undertaking, more so as corporations are still functioning within the constraints posed by the COVID-19 crisis.

In addition to this large segment of transactions with financial counterparties, there are other categories of exposure that Main Street companies must address, although there have been no meaningful estimates of the commercial exposure NFCs manage as a result of business contracts they enter into as part of their day-to-day operations. Examples include:

- Inter-affiliate and intra-group loans for cash management within a corporate group;
- Employee benefit payments to adjust for payment delays;
- Accounting uses to calculate the fair value of contracts, leases, derivatives, and for the capitalization of interest;
- Asset purchase and sale agreements to adjust for closing date changes and other timing differences;

³ Interagency Statement on LIBOR Transition, November 30, 2020, <https://www.federalreserve.gov/supervisionreg/srletters/SR2027a1.pdf>

- Supply agreements to make adjustments for volume variances and payment date changes; and
- Long-term capital goods purchases to allow for milestone timing differences.

To illustrate the uncertainty NFCs are subject to in day-to-day commercial agreements, consider the examples below:

Example - Worldwide Supply Agreement

- In today's competitive marketplace, many Main Street companies enter into worldwide supply contracts in which they agree to buy all their needs for a particular commodity, or other input to their production process, if the supplier will give a volume discount for the quantity purchased.
- In many of these agreements, the discount is negotiated to be paid up-front in anticipation of annual targeted purchases. If, however, the target is missed, the typical contract will call for a payment back to the supplier with the formula including LIBOR for the calculation.
- If LIBOR ceases to be quoted, the parties to most supply agreements will have to negotiate a mutually acceptable resolution. During this negotiation, a supplier may suspend deliveries and a customer might withhold payments causing a major disruption in the economy.
- The parties whose contracts are in dispute could very likely tie up state and federal courts with a logjam of cases.
- Often in the case of long-term supply agreements, prices will have moved since inception and one of the parties will have an incentive to hold out for a price or quantity adjustment, making resort to the courts more likely by the advantaged party seeking to preserve its contractual benefit.

Additional Example – Long-term Construction Agreement

- Consider the purchase of a major piece of equipment where the construction process from order to delivery will take many months.
- For example, state-of-the-art machines for paper production cost several hundred million dollars and can take over two years to construct. The paper company and the paper machine supplier enter into a multi-year purchase agreement that calls for periodic payments to be advanced by the customer upon the machine manufacturer's completion of designated milestones.
- If, however, the production of the paper machine falls behind schedule and a milestone is missed, the contract will call for a reduction in the purchase price based on a calculation using LIBOR.
- Most of these types of agreements outstanding today were negotiated without any thought of what rates would apply if LIBOR were no longer quoted and are without fallback provisions.

These are just two scenarios that demonstrate the various complexities – potential renegotiation of a replacement rate, delays in supplies and business operations, state and federal court cases, contracts without fallback provisions – that NFCs must navigate during the transition away from LIBOR. Despite the additional time granted by the FCA to comply with certain maturities of contracts, the transition away from LIBOR remains a daunting task. A major obstacle to a smooth transition is the sheer number of existing contracts that are impacted by the transition. It is impractical to require U.S. corporations to renegotiate many thousands of contracts, including those with foreign counterparties, given the LIBOR cessation event that was decided by the LIBOR administrator. It should be noted that regulators and responsible authorities in the U.S. and U.K. have warned that despite the hoped-for transition timetables, unforeseen disruptions in the financial markets could interrupt quotations of LIBOR at any time.

Given these many challenges to NFCs as they transition away from LIBOR, it is imperative that Congress acts quickly to support a seamless transition effort. We urge this Subcommittee to consider how its oversight of financial market regulation as well as possible federal legislation could help to resolve affected legacy contracts following the cessation of LIBOR rate publication and to ensure conformity with the Trust Indenture Act of 1939.⁴

We thank you for considering our comments and welcome answering any questions on this issue.

Respectfully,



Thomas Hunt
Association for Financial
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Thomas C. Deas, Jr.
National Association of
Corporate Treasurers



Tom Quaadman
Center for Capital Markets
Competitiveness of the U.S.
Chamber of Commerce

⁴ Trust Indenture Act of 1939 – 15 U.S.C. §§ 77

Appendix A
Survey of Borrowers
Nonfinancial Corporates Working Group
Alternative Reference Rates Committee
March 2021

