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Legal Update

FINRA LIBOR Phase-Out Preparedness Survey

The Financial Industry Regulatory Authority, Inc. ("FINRA") conducted a survey of common practices implemented by broker-dealer firms to prepare for the transition away from using the London Interbank Offered Rate ("LIBOR").[1] On August 5, 2020, FINRA published Regulatory Notice 20-26, which lists important considerations when phasing out LIBOR, and summarizes the results of a recent survey of FINRA members to gauge their preparedness for the move away from LIBOR. Importantly, the Regulatory Notice identifies practices that firms have already undertaken to ease the transition.

Background

FINRA notes that there are LIBOR-based contracts with an estimated value of $35 trillion that extend past the December 31, 2021 phase-out date, which will have significant consequences for broker-dealers, as well as their customers and counterparties. LIBOR cessation may increase a broker-dealer's exposure to risks relating to compliance requirements, adverse financial and accounting issues, disruptions to business operations, and related litigation with customers, counterparties or third-party providers. It is therefore imperative that broker-dealers with exposure to LIBOR implement a plan to prepare for the LIBOR phase-out. To that effect, per its *2020 Risk Monitoring an Examination Priorities Letter*, FINRA has engaged with firms to understand how they are preparing for the transition.[2]

Preparedness Considerations

FINRA surveyed firms on a number of matters they consider important in firms' preparations for the LIBOR phase-out. Although non-exhaustive, this list provides a framework for firms to consider as they design and implement their own phase-out plans.

- Has your firm evaluated the impact of the phase-out on your business, customers, counterparties, products and vendors and developed a plan to prepare for the phase-out?
- Can your firm measure its own exposure to LIBOR-linked products that expire after the phase-out date?
- Can your firm identify LIBOR-linked products that expire after the phase-out date in accounts customers hold at the firm?
- Has your firm evaluated potential risks related to fallback provisions (or the absence of such provisions) for securities

and contracts referencing LIBOR and expiring after the phase-out date?

- Has your firm identified business processes, systems and vendors that may be affected by the phase-out, and developed plans to mitigate operational risks arising from the phase-out?
- Has your firm engaged in opportunities industry organizations have provided to learn about effective practices for transitioning to alternative reference rates to replace LIBOR, as well as other IBORs?
- Has your firm trained your associated persons and other staff about the potential impact of the phase-out on your firm's customers?
- Has your firm prepared guidance for associated persons and other staff relating to communicating to customers the impact of the phase-out for your firm, your firm's clients and customers, and any LIBOR-linked products that expire after the phase-out date?
- How is your firm preparing to supervise associated persons' recommendations relating to LIBOR-linked products?

FINRA Survey Results

The results of FINRA's survey found that while some firms had taken material and concrete actions to prepare for LIBOR cessation, others had, as of yet, done little to prepare for the transition away from LIBOR. The chart that follows summarizes these results by categorizing certain common practices adopted by the surveyed firms.

If your firm has not already considered its approach to its transition away from LIBOR (or other IBORs), the time to begin is now. Regulators expect firms to be prepared for the December 31, 2021 phase-out date, and there is the potential for substantial exposure to risk if firms are not adequately prepared. The practices laid out by FINRA should serve as a good starting point, but each firm should tailor its LIBOR phase-out program to suit its needs.

If you have any questions about how your firm should prepare for LIBOR cessation, please contact the authors or any member of our Broker-Dealer Regulation & Compliance practice. We are here to help with any questions of interpretation or assistance with compliance with the expectations of regulators. In addition, we will continue to monitor developments relating to the LIBOR phase-out and provide regular updates.

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Endnotes

[1] FINRA, Regulatory Notice 20-06, FINRA Shares Practices Firms Implemented to Prepare for the LIBOR Phase-out (Aug. 5, 2020), https://bit.ly/3guzdrH.

[2] See FINRA, 2020 Risk Monitoring and Examination Priorities Letter (Jan. 9, 2020), https://bit.ly/31o87w9.

Category	Practices Observed by FINRA
Governance Framework	• assign responsibility for preparing for and managing the phase-out to specific business units, project teams, project management offices or other ad hoc committees; • include relevant staff from departments across the firm in phase-out planning efforts to provide a cross-functional view on the potential impacts of the phase-out; and • develop and implement comprehensive phase-out plans that: (i) identify policy, organizational, process and information system change requirements for the post-phase-out operating environment; (ii) identify dependencies across change management plans and measure progress towards achieving those goals; and (iii) set timelines with required interim deliverables (while also providing for flexibility to accommodate potential changes to phase-out requirements).
Financial Risk	• identify its inventory, as well as their customers' holdings, of products and contracts maturing or planned to be rolled over after the phase-out date; • classify financial risk exposures into categories in order to better evaluate the firm's risk profile; and • estimate firm and customer gross notional exposure for products and contracts maturing or planned to be rolled over after the phase-out date.
Operational Risk	• develop an inventory of business processes, business units, information systems and vendors that would be impacted by the phase-out, including front, middle and back-office functions; • conduct an inventory of market, credit and liquidity models that reference LIBOR (or other IBORs being phased out), identifying appropriate alternative reference rates and testing them with the appropriate new reference rate(s); and • determine responsibility between introducing and clearing firms for operational functions impacted by the phase-out.
Alternative Reference Rates	• participate in or monitor industry organizations, such as the International Swaps Dealer Association ("ISDA"), the Alternative Reference Rates Committee ("ARRC"), to further understand recommendations and protocols for adopting alternative reference rates, as well as learn about other firms' solutions for managing some of the most challenging issues the phase-out poses; and • consider alternative rates (in addition to SOFR), which include, but are not limited to, other risk-free rates, such as SONIA, TONAR, ESTER and SARON.
Legal Risk	• conduct an inventory of all contracts impacted by the LIBOR phase-out; and • review or develop fallback language, and renegotiate and repaper contracts, as needed, leveraging resources from ARRC and ISDA.
Staff Training and Customer Education	• train client-facing office and other staff about firm plans and related implications of the phase-out (including in-person training, webinars, emails, podcasts, FAQs and town hall discussions); • develop centralized, internal knowledge-sharing sites for resources, communication and guidance relating to the phase-out; • communicate with customers about the firm phase-out timeline, as well implications for customers' products; and • provide disclosures on firm websites and customer communications about the phase-out, including its impact on customers, counterparties, third parties and products.

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