BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

SR 21-12

July 29, 2021

Revised November 19, 2021

In November 2021, this letter was revised to provide additional frequently asked questions in response to questions from institutions regarding the transition away from using LIBOR as a reference rate. The updated FAQs, together with the FAQs issued in July 2021, are attached to this letter.

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: Answers to Frequently Asked Questions on the Transition Away from London Interbank Offered Rate (LIBOR)

Applicability: This guidance applies to all financial institutions supervised by the Federal Reserve, including those with $10 billion or less in consolidated assets

The Federal Reserve is issuing frequently asked questions (FAQs) to assist its supervised firms in the transition away from using the **LIBOR** as a reference rate.

This letter announces the initial set of FAQs on this topic, which are included in the attachment to this letter. The Federal Reserve may periodically update the FAQ document; therefore, institutions are encouraged to check the Board's public website for new FAQs or revisions to a previously issued FAQs.

Reserve Banks are asked to distribute this letter to the supervised firms in their districts and to appropriate supervisory staff. In addition, supervised firms may send questions regarding this topic via the Board's public website.[1]

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

Michael S. Gibson
Director
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Attachments

- Attachment A: Answers to Frequently Asked Questions on the Transition Away from LIBOR (Effective July 29, 2021)
- Attachment B: Answers to Frequently Asked Questions on the Transition Away from LIBOR (Effective November 19, 2021)

Attachment A: Answers to Frequently Asked Questions on the Transition Away from LIBOR

Effective July 29, 2021

Regulatory Capital Rule FAQs on LIBOR transition

FAQ Topics:

1) *Redemption or reissuance of regulatory capital instruments*

   Question: Would replacing or amending the terms of a capital instrument to transition from the London Interbank Offered Rate (LIBOR) to another reference rate or rate structure be considered an issuance of a new instrument under the capital rule (12 CFR 217) for purposes of the eligibility criteria for regulatory capital?

   Answer: The Board of Governors of the Federal Reserve System (Board) does not consider the replacement or amendment of a capital instrument that solely replaces a reference rate linked to LIBOR with another reference rate or rate structure to constitute an issuance of a new capital instrument for purposes of the capital rule. If changes in the terms of the replacement or amended capital instrument solely relate to the adoption of the new reference rate or rate structure, and there are no substantial differences from the original instrument from an economic perspective, the replacement or amended instrument would not be considered a new instrument for purposes of the eligibility criteria for regulatory capital. In this case, for purposes of the capital rule, the replacement or amended instrument would retain the maturity of the original instrument.

   A Board-regulated institution that replaces or amends the terms of a capital instrument to transition from LIBOR should support its determination with an appropriate analysis that demonstrates that the replacement or amended instrument is not substantially different from the original instrument from an economic perspective. The Board may request that the Board-regulated institution provide this analysis. Considerations for determining that a replacement or amended capital instrument is not substantially different from the original instrument from an economic perspective could include, but are not limited to, whether the replacement or amended instrument has amended terms beyond those relevant to implementing the new reference rate or rate structure.

2) *Regulatory capital instruments with changing distribution rates*

   Question: For purposes of the eligibility criteria for regulatory capital, would replacing or amending the terms of a capital instrument to transition from the London Interbank Offered Rate (LIBOR) to another reference rate or rate structure be considered creating an incentive to redeem the instrument under the capital rule (12 CFR 217)?

Answer: The Board does not consider the replacement or amendment of a capital instrument that solely replaces a reference rate linked to LIBOR with another reference rate or rate structure to constitute creating an incentive to redeem, as long as the replacement or amended capital instrument is not substantially different from the original instrument from an economic perspective. For example, amending the credit spread solely to reflect the difference in basis between LIBOR and the replacement reference rate and not adjusting for changes in the credit quality of the issuer would not result in creating an incentive to redeem the capital instrument.

A Board-regulated institution that replaces or amends the terms of a capital instrument to transition from LIBOR should support its determination with an appropriate analysis that demonstrates that the replacement or amended instrument is not substantially different from the original instrument from an economic perspective. The Board may request that the Board-regulated institution provide this analysis. Considerations for determining that a replacement or amended capital instrument is not substantially different from the original instrument from an economic perspective could include, but are not limited to, whether the replacement or amended instrument has amended terms beyond those relevant to implementing the new reference rate or rate structure.

Total Loss-Absorbing Capacity (TLAC) FAQs on LIBOR transition

FAQ Topics – U.S. GSIBs, Subpart G of Regulation YY:

3) *Exchange or amendment of eligible debt securities*

Question: If a global systemically important BHC (GSIB) exchanges or amends an "eligible debt security"(12 CFR 252.61) to transition from the London Interbank Offered Rate (LIBOR) to another reference rate or rate structure, would that be considered an issuance of a new debt security for purposes of the eligibility criteria for the TLAC rule or a continuation of the original "eligible debt security"?

Answer: For purposes of Subpart G of the Board's Regulation YY, if a GSIB conducts an exchange of eligible debt securities or amends such securities' terms in order to replace outstanding debt securities that reference LIBOR with debt securities that contain a substantially equivalent reference rate or other rate structure, and no other changes are made to the debt securities, the replacement or amended debt securities are not considered newly issued debt securities. The GSIB may treat the replaced or amended debt securities as if they were the originally outstanding debt securities that referenced LIBOR, rather than treating the debt securities as new debt securities issued on the date of the exchange or amendment. In this case, for purposes of Subpart G of the Board's Regulation YY, the exchanged or amended debt securities would retain the maturity of the original eligible debt securities.

A GSIB that exchanges an eligible debt security or amends such security's terms to transition from LIBOR should support its determination with an appropriate analysis that demonstrates that the replacement or amended security is not substantially different from the original security from an economic perspective. The Board may ask the GSIB to provide the analysis upon request. Considerations for determining that a replacement or amended eligible debt security is not substantially different from the original security from an economic perspective could include, but are not limited to, whether the replacement or amended instrument has amended terms beyond those relevant to implementing the new reference rate or rate structure.

4) *Exchange offers of eligible debt securities for LIBOR replacement purposes*

Question: May a global systemically important BHC (GSIB) conduct an exchange or tender offer for securities issued by the top-tier GSIB directly with third party holders in order to facilitate the GSIB's transition away from U.S. dollar (USD) LIBOR?

Answer: The Board encourages GSIBs to transition away from USD LIBOR as soon as practicable, and in any event by December 31, 2021. If a GSIB's exchange offer of securities issued by the top-tier GSIB directly to third party holders would facilitate such

a transition, and is subject to appropriate limitations, such a transaction would not be inconsistent with the purposes of Subpart G of the Board's Regulation YY to enhance GSIB resolvability. Therefore, staff would not recommend that the Board take an enforcement action if a GSIB were to enter into such a transaction where the following conditions are satisfied:

1. The exchange offer will occur prior to the date that the relevant USD LIBOR tenor ceases to be published or becomes nonrepresentative and is for the purpose of exchanging legacy securities to facilitate the transition of the GSIB away from USD LIBOR;
2. Under the exchange offer, the period for which the GSIB will be subject to a legal obligation to settle a contract with tendering holders will be five business days or less;
3. The amount of securities covered by the exchange offer will not exceed the lesser of 5 percent of the GSIB's total risk-weighted assets and 2.5 percent of the GSIB's total leverage exposure; and
4. The GSIB will be well capitalized and in compliance with the Board's liquidity coverage ratio rule at the time the GSIB commences the exchange offer.

FAQ Topics – Covered IHCs, Subpart P of Regulation YY:

1) *Exchange offers of eligible covered IHC debt securities for LIBOR replacement purposes*

   Question: If a covered IHC exchanges or amends an "eligible covered IHC debt security" (12 CFR 252.161) to transition from the London Interbank Offered Rate (LIBOR) to another reference rate or rate structure, would that be considered an issuance of a new debt security for purposes of the eligibility criteria for the TLAC rule or a continuation of the original "eligible covered IHC debt security"?

   Answer: For purposes of Subpart P of the Board's Regulation YY, if a covered IHC conducts an exchange of eligible covered IHC debt securities or amends such securities' terms in order to replace outstanding debt securities that reference LIBOR with debt securities that contain a substantially equivalent reference rate or other rate structure, and no other changes are made to the debt securities, the replacement or amended debt securities are not considered newly issued debt securities. The Covered IHC may treat the replaced or amended debt securities as if they were the originally outstanding debt securities that referenced LIBOR, rather than treating the debt securities as new debt securities issued on the date of the exchange or amendment. In this case, for purposes of Subpart P of the Board's Regulation YY, the exchanged or amended debt securities would retain the maturity of the original eligible covered IHC debt securities.

   A covered IHC that exchanges an eligible covered IHC debt security or amends such security's terms to transition from LIBOR should support its determination with an appropriate analysis that demonstrates that the replacement or amended security is not substantially different from the original security from an economic perspective. The Board may ask the covered IHC to provide the analysis upon request. Considerations for determining that a replacement or amended eligible covered IHC debt security is not substantially different from the original security from an economic perspective could include, but are not limited to, whether the replacement or amended instrument has amended terms beyond those relevant to implementing the new reference rate or rate structure.

2) *Exchange offers of eligible covered IHC debt securities for LIBOR replacement purposes*

   Question: May a resolution covered IHC conduct an exchange or tender offer for securities issued by the resolution covered IHC directly with third party holders in order to facilitate the resolution covered IHC's transition away from U.S. dollar (USD) LIBOR?

   Answer: The Board encourages covered IHCs to transition away from USD LIBOR as soon as practicable, and in any event by December 31, 2021. If a covered IHC's exchange offer of securities issued by the top-tier covered IHC directly to third party holders would facilitate such a transition, and is subject to appropriate limitations, such a

transaction would not be inconsistent with the purposes of Subpart P of the Board's Regulation YY to enhance covered IHC resolvability. Therefore, staff would not recommend that the Board take an enforcement action if a covered IHC were to enter into such a transaction where the following conditions are satisfied:

1. The exchange offer will occur prior to the date that the relevant USD LIBOR tenor ceases to be published or becomes nonrepresentative and is for the purpose of exchanging legacy securities to facilitate the transition of the GSIB away from USD LIBOR;
2. Under the exchange offer, the period for which the covered IHC will be subject to a legal obligation to settle a contract with tendering holders will be five business days or less;
3. The amount of securities covered by the exchange offer will not exceed the lesser of 5 percent of the covered IHC's total risk-weighted assets and 2.5 percent of the covered IHC's total leverage exposure; and
4. The covered IHC will be well capitalized and, if applicable, in compliance with the Board's liquidity coverage ratio rule at the time the covered IHC commences the exchange offer.

Attachment B: Answers to Frequently Asked Questions on the Transition Away from LIBOR

Effective November 19, 2021

Supervision FAQs on the Transition away from LIBOR

1. **After December 31, 2021, would supervisors view a modification to a LIBOR-referenced adjustable-rate mortgage as a new contract?**

   Supervisors would not view a modification to a LIBOR-referenced adjustable-rate mortgage as a new contract unless it (i) creates additional LIBOR exposure for a supervised institution or (ii) extends the term of the mortgage.

2. **If a loan contract will automatically renew after December 31, 2021, would this be viewed as a new contract?**

   Yes, the automatic renewal of the loan would be viewed as a new contract because it would extend the term of an existing LIBOR contract. A Board-supervised institution should take steps to address such automatic renewals.

3. **Would the physical settlement of a contract that existed prior to year-end 2021 (e.g., a swaption) be viewed as a new contract?**

   No, this would not be viewed as a new contract.

4. **Would it be appropriate for Board-supervised institutions to enter into *any* new LIBOR contracts after December 31, 2021?**

   As stated in SR Letter 20-27 and SR Letter 21-17, there may be limited circumstances in which it would be appropriate for an institution to enter into new USD LIBOR contracts after December 31, 2021, such as (i) transactions executed for purposes of required participation in a central counterparty auction procedure in the case of a member default, including transactions to hedge the resulting USD LIBOR exposure; (ii) market making in support of client activity related to USD LIBOR transactions executed before January 1, 2022; (iii) transactions that reduce or hedge the institution's or any client of the institution's USD LIBOR exposure on contracts entered into before January 1, 2022; and (iv) novations of USD LIBOR transactions executed before January 1, 2022.

   A Board-supervised institution should have reasonable measures in place to assess whether a new USD LIBOR contract would be consistent with safety and soundness practices. These measures should align with the institution's existing risk management processes.

5. **After December 31, 2021, would it be appropriate for Board-supervised institutions to engage in secondary trading of LIBOR-linked cash instruments issued prior to year-end 2021?**

   Yes, it would be appropriate to engage in secondary trading of LIBOR-linked instruments issued prior to December 31, 2021.

6. **Should Board-supervised institutions include fallback language in LIBOR contracts entered into on or before December 31, 2021?**

   As stated in SR Letter 21-17, LIBOR contracts entered into on or before December 31, 2021, should either use a reference rate other than LIBOR or have fallback language that provides for use of a strong and clearly defined alternative reference rate after LIBOR's discontinuation. Such fallback language will ensure there are no

disagreements between the parties to a LIBOR contract about how to calculate interest when LIBOR is no longer available.

7. How will examiners assess Board-supervised institutions' LIBOR transition planning? Will supervisors issue MRAs and take other supervisory actions in connection with the LIBOR transition?

Consistent with SR Letter 21-7, examiners first assess whether a Board-supervised institution has exposure to LIBOR. For institutions with LIBOR exposure, examiners have focused on (1) transition planning; (2) financial exposure measurement and risk assessment; (3) operational preparedness and controls; (4) legal contract preparedness; (5) communication; and (6) oversight.

Board-supervised institutions that are not making adequate progress toward transitioning away from LIBOR could create safety and soundness risks for themselves and for the financial system. Accordingly, examiners will consider issuing supervisory findings and other supervisory actions if a firm is not making adequate progress.