April 27, 2021

The Honorable Janet Yellen
Secretary
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable John Williams
President and Chief Executive Officer
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

The Honorable Gary Gensler
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Rostin Behnam
Acting Chairman
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Transition to the Secured Overnight Financing Rate – The Views of Nonfinancial Corporations

Dear Secretary Yellen, Chairman Powell, President Williams, Chairman Gensler, and Acting Chairman Behnam:

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 now that the timetable is set for the transition away from the London Interbank Offer Rate (LIBOR). Our respective organizations are members of the Alternative Reference Rates Committee (ARRC) and we are committed to assisting you in ensuring a successful transition from U.S. dollar LIBOR to SOFR as the far 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.

To aid you in your ongoing roles overseeing the financial markets, we would like to share with you the various challenges that the LIBOR transition represents to the community of nonfinancial corporates (NFCs). We appreciate your continued support of the ARRC's efforts on the LIBOR transition and further welcome your guidance in encouraging banks and securities underwriters to accelerate their ability to provide NFCs with relevant transition materials and to be at the ready to offer NFCs with SOFR-indexed financings. As we detail below, NFCs are increasingly concerned that given the current state of progress there will be insufficient time for their companies to complete an orderly transition before LIBOR ceases to be quoted.

We would very much appreciate the opportunity to have a virtual meeting with you and your staffs to discuss the specific challenges of the LIBOR transition to NFCs. If it is agreeable to you, we would also include in the discussion practicing corporate treasurers who have shared their expertise with the Nonfinancial Corporates Working Group in an effort to speed the LIBOR transition for NFCs.

LIBOR Transition

As you well know, 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 U.S. dollar LIBOR where $500 million of underlying inter-bank transactions, from only 16 panel banks of which just 3 are based in the U.S., 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 as we saw in 2008 and again most recently in March 2020.

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, as the ARRC has warned often, 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.

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[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

Most financial market participants are aware that LIBOR's administrator, the ICE Benchmark Administration, will cease publishing the LIBOR rate very soon, forcing them to transition to a replacement rate. With nearly $200 trillion of financial contracts referencing 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 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.

The recent warnings by the Prudential Banking Regulators[3] put the banks on notice that they 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 and internal compliance and technology systems in advance of when LIBOR ceases to be quoted, 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. To illustrate further the importance to NFCs of expeditiously determining new borrowing methods with their banks, please consider below the variety of financial instruments subject to the transition.

An important 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.

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

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;
- 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.

<u>Additional Example – Long-term Construction Agreement</u>

- 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 and the complexities of changing internal systems in advance of receiving specific proposals from banks specifying the detailed mechanics of loan administration. We are mindful that in the U.S. and the U.K. we have all been warned that despite the hoped-for transition timetables, unforeseen disruptions in the financial markets could interrupt quotations of LIBOR at any time.

We thank you for considering our comments and would welcome the opportunity to discuss these issues further with you and your staffs.

Respectfully,

Thomas Hunt
Director of Treasury Services
Association for Financial Professionals

Thomas C. Deas, Jr.
Chairman
National Association of Corporate Treasurers

Tom Quaadman
Executive Vice President
Center for Capital Markets Competitiveness, U.S. Chamber of Commerce

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