Intro:

Welcome to the Treasury Update Podcast presented by Strategic Treasurer, your source for interesting treasury news, analysis and insights in your car, at the gym, or wherever you decide to tune in. On this episode of the podcast, Craig Jeffery leads a discussion with Tom Hunt, CTP Director of Treasury Services at the Association for Financial Professionals, to discuss their action and advice on LIBOR replacement. The upcoming change of this wildly used rate will have a major impact on companies around the globe. Listen in to the discussion to learn how the AFP is helping companies know what is happening, when that impacts them, and how to successfully prepare.

Craig Jeffery:

Welcome to the Treasury Update Podcast. This is Craig Jeffery. Today's episode is on a topic that everyone should be interested in if you have any contract - LIBOR replacement: AFP Action and Advice. The replacement of a long running and widely used rate for various contracts and debt such as LIBOR will have a major impact on the companies that participate in the Association of Financial Professionals. LIBOR will sunset after 2021, and is the most widely used base rate. This change is having a massive impact. Few are fully ready for this marathon, and many aren't sure what to do. The AFP is helping companies know what is happening, how that impacts them, and what they should know, monitor, think and do. Welcome to the podcast, Tom.

Tom Hunt:

Thank you, Craig. I'm glad to be here.

Craig Jeffery:

You educate the community on so many different items including on LIBOR, and I wanted to start off asking if you'd give us a quick high level summary of what's going on with LIBOR.

Tom Hunt:

LIBOR, being the world's largest probably financially identified rate is definitely something that's impacting our members, but more importantly it's taking upon more of an industry convention towards adoption. So with that, it's something looking to identify a replacement rate through SOFR, but it's also, there's a lot of industry movement in terms of what the alternative Reference Rate Committee is doing, and AFP just recently joined that. And so, getting up to speed quickly on what's going on with the ARRC in terms of timeline, and moving towards the end of 2021 deadline, there's still a lot of work yet to be done. And the ARRC has put out a request for comment, or a spread adjustment methodology for people to make comment on. That's probably the latest update on LIBOR, but in terms of hitting other milestones, the derivatives piece is still yet to come with the efforts that ISDA is leading in terms of protocol that they're going to be coming out with, but also more so importantly, the term structure of rates, which we hopefully will see by the end of 2021.

Tom Hunt:

From our members standpoint, probably the two biggest areas that have impact on LIBOR are through loans, loan syndications, term loans, and derivatives, and forwards, and options. But aside from that, the ARRC is involved in a lot of other methodologies around that, and some of what's important to the industry might not be as important to our members. So just making sure what's getting in front of our members is first and foremost on top of mind for them. What we're realizing is, a lot of our members are still taking a very much wait and see approach, especially if they only have three or four exposures to LIBOR, either in derivatives, contracts, or in loan syndications. And then, if they do have exposure, what's the timing of that? Is it going to end before 2021 with LIBOR possibly going away, or not being reported by the member panel banks? That's really kind of from our standpoint what the crux of the issue is.

Tom Hunt:

And working in conjunction with the ARRC, and conjunction with our members, and then players in the financial ecosystem to bring together a cohesive working group to help move this forward to bring light into an issue that LIBOR is probably ... as far as I know, it's been around a long time, and it's so heavily referenced in a lot of financial documents, and making this change will be a big change.

Craig Jeffery:

So did you say that you've put together a working group within the AFP?

Tom Hunt:

Oh yeah, so we convened a couple of times back in August and November. We've been involved probably in LIBOR since our annual conference in 2018. We had a panel with a Federal Reserve representative, LSTA, and ISDA, and a corporate member. And we addressed the issue then, and that was really kind of the leading off standpoint. From the working group standpoint, with AFP, we're really focused more or less on what is the true impact to the corporate treasury professionals. And so, we've convened a working group internally to really highlight the overall impacts of where LIBOR is affecting our members, and what you can do about it, or what you need to do about it. Or it's not necessarily best practices, but it's offering insight into what the new convention could be for certain instruments, or what to do if you've got something that's going to be a holdover into 2021, or 2022. So, it's addressing some of those issues around investments, loans, a lot of other areas that might have some impact or insight from LIBOR.

Craig Jeffery:

Right, maybe less popular is trade credit. But the question I had was, if you could give us a little more detail on the impact of corporate treasury. Now you've already talked about loans, derivatives, and we just talked about some trade credit, but what's the scale and the scope of these changes? So when people are thinking about it, what is this going to impact? Is this going to impact our processes, just our contracts, our systems? What's the scope?

Tom Hunt:

And that's a great question. When we look at it, and we try to identify where the total LIBOR exposure is, right? So it's, 95% of roughly $200 trillion of LIBOR exposure is in derivatives. So that's probably a big component of our members, but it's also a component that is not as big in terms of the overall market. So there's a lot of other derivatives trading that goes on that we don't necessarily have. Our members don't necessarily see that. The rest, now the $10 trillion or so is then made up of areas that definitely impact our members. So in business loans, floating rate debt, securitizations, and then there's a smaller segment of that component, which are retail mortgages, but that's not necessarily where our numbers play in. But for that $8 to $9 trillion of where the exposure is. Yes, I think to the answer to your question. I think you have to look at the whole ecosystem, because if a corporate has three or four exposures, realizing that their counterparty has several hundred thousand, it's more or less doing your due diligence, right?

Tom Hunt:

So it's asking your counterparts on the loan side, if you've got a syndication, and if it's a five-year deal, and it's going to be held over 2021, what's the event if LIBOR goes away, and your outstanding borrowings are tied to LIBOR, what's the replacement rate? Things like that, but it's also, can your counterparts, your admin agent of your syndication, can they handle those changes? Can your lead agents ... what's their exposure? It's just asking the question. Every loan syndication is different to the borrower with that, so every bank participant that's got a piece of that, you have to ask the question, "Okay, what's the plan of action here?" And I don't want to ... if I'm the borrower, I don't want to take on a change in LIBOR from a unilateral standpoint, and be given a different rate that's not favorable to me.

Tom Hunt:

But then on the other hand, with ... so for ... where it's different with LIBOR, it's not a rate that has a credit component to it. So there's a lot of discussion around the credit spread adjustments. And so how is that going to be put in? But to your question, there's a larger financial ecosystem aspect of this, in terms of all the trading systems to the custodian systems, to the DTCC, to anywhere where registration of securities occurs, things have to be able to justify, and take in a different rate.

Tom Hunt:

But it's also from the corporate standpoint, they're at the top of the pyramid and they're at the top of the iceberg, right? So their exposure is very small, but when they look at all their counterparts, they might be much larger. So from a TMS standpoint, are they making updates and changes? So, you kind of really have to look at the four or five exposures you have, and really understand the underlying impacts, because it might not be within your control, and the fallback rate, or the rate referenced in your contracts might be something less than favorable. Doing your due diligence and understanding what you're potentially be up against is really what a lot of our members are just now starting to identify, or are going to be identifying probably this year and into next year.

Craig Jeffery:

Yeah, that's good, Tom. A couple of things that you said stood out that I wanted to follow up on. One was the ... you talked about talking to your various counterparties on the other side of the credit, or your treasury system, or your risk system folks. I can picture there being a lot more FAQs, frequently asked questions coming out on LIBOR from these different counterparties to help get ahead of it. I think that's probably well in order. I haven't seen too many of those come out. I've seen people write some papers on them, but that's probably something that will start to show up.

Tom Hunt:

The ARRC has actually done a few papers on that, more from the standpoint of the financial providers. It's provided some insight into what our members could ultimately try and use, but realizing it might be more from the asset manager's standpoint, or it might be more from market convention. From an AFP standpoint, we definitely want to be a resource to our members. So we've definitely got our LIBOR page up and running. Any new developments, we're updating information on there. And so, as much as a resource we can be, we definitely want to be.

Craig Jeffery:

Yeah, I want to ask you some more questions on that, but just before we do, I just wanted to talk about the magnitude. So you mentioned $200 trillion of exposures, whether it's derivatives, or otherwise, are covered under the LIBOR rate. That's a little bit more than 2X, the combined GDP of all the countries in the world. And then you mentioned a number $8 to $10 trillion on the debt side, is that right?

Tom Hunt:

Mm-hmm (affirmative), yeah. They call it the cash side, which is loans, floating rate debt, and securitizations.

Craig Jeffery:

Yeah, that's about half of the US GDP. So when we think the size of this market, that's relying on this rate that's been around for decades, it is massive. And Tom, thanks for your work at the AFP, looking out for its members. And I know I guess as an association, the AFP does a great annual conference. I know this next year's one is in Las Vegas. Last year was in Boston. You guys do a great job with that, but as an association, you do advocacy, you dialogue on topics, you provide education, and I really appreciate how you're taking a very proactive and strong and effective leadership position on this topic. So thank you for from the industry for that. Can you tell us a little bit more about what the AFP is doing on these fronts to help its members? I know you talked about participating in ARRC, starting with the AFP Annual Conference in 2018 addressing this, I know you've done some podcasts, papers. Maybe just share some of the resources that you have, and some of the other actions that you've done.

Tom Hunt:

Definitely. So we've got our LIBOR page that we've got content flowing into that, so ...

Craig Jeffery:

We'll put that into the episode notes, so you guys can just click on that. ([Find here](https://dynamic.afponline.org/libor/p/1).)

Tom Hunt:

Yeah, so we've done a lot of collaboration early on with participants on the ARRC. So the LSTA, or the Loan Syndications and Trading Association, ISDA, the Federal Reserve have really ... probably those three have really been our main counterparts, just from the standpoint of what is most important to our members, focusing on that. And probably the loan side of it really is where our members will probably have the greatest impact. If it's derivative, there's a protocol coming out from his ISDA. Maybe you go ahead and cancel out your contract, or you trade out of it, or there's a market component to it. From a standpoint of on the loan side, I think there's a potential of where our members are probably going to be ... they're going to want to be put in the best position on equal footing.

Tom Hunt:

In terms of our resources in providing most insight to them, that's where we have focused a lot of our efforts on our resources, and we're also in the process of creating a checklist tool for our members. So basically, if you've read our Essentials of Treasury Management, or the CTP Handbook, as it were, we went through and pulled out every type of financial instrument listed in that book that we could find. And basically through efforts with the ARRC and efforts with ISDA, and LSTA, and other members, and other bank participants, and risk managers, we've gone through and really with a fine toothed comb, looked instrument by instrument to say, "Okay, if you're on this side of an asset, in particular, if you're in an investment, it's a floating rate instrument, and it's going to mature past 2021, what are your options?"

Tom Hunt:

So we're really looking at this more so from a very much more of a micro-level than a lot of what the ARRC has done as an offshoot of our efforts with participants of the ARRC, but it's really going to be a nice resource for members to ... basically it's more or less a checklist. So really understanding, if I've got supply chain financing, what do I need to be cognizant of? If I've got trade credit and letters of credit, what are my options? We're always looking for more participants to lend a hand in the efforts. Through our two meetings that we've had here at AFP, we've put together 15 to 20 individuals that have really provided insight into that, including members, corporate members, especially if they're a heavy in the securitization side of the transactions. But then also, any corporate member with the standard loan syndications, as simple as that, and derivatives, of course. It's really much more of a micro-perspective of treasury in terms of instrument by instrument, and what should you do before 2021, what should you do after, and what are things to consider?

Tom Hunt:

Corporates are really going to have to work with a lot of their internal legal teams, with their tax teams because LIBOR, as you well know, there's a huge component of in-house banking. There's things that we're finding in just not necessarily purchase orders, but just in purchase agreements. If there's a reference to LIBOR for late payments, or things like that is just knowing where your exposures are, and we're hoping that this checklist will really help members identify places to consider looking, and then provide insight into what paths of follow-up might be.

Craig Jeffery:

I can just picture Treasury asking Legal, "Please do a search for the word LIBOR in all our contracts," and then seeing the scare, the fear that comes up from that.

Tom Hunt:

Yeah, you think about a loan syndication, right? So if you've got a multicurrency aspect to it, you might not plan on borrowing or drawing down on any of that, but in the event you do which ... and SOFR is the US convention for LIBOR, but what are the other IBORs, and where's your currency exposure to? If you're going to borrow yen, what's your IBOR alternative there? Going back to the earlier question about understanding the ecosystem, so you think about just internally the discussions you might have for larger corporates with their legal teams, all those conversations are going to be compounded by all of the borrowers that are going to be calling upon their lending institutions to ask these questions. So the sooner they can jump on this, the better.

Tom Hunt:

And a lot of what I've understood that our members are doing is they're just leaving the option open for a reference rate in a loan syndication, if they're re-upping, or refinancing, or structuring out some of their loans, indications. They're just leaving kind of a blank spot for, "We agree that we'll agree later," basically is what it amounts to. So it's kind of a little bit of kicking the can down the road, but still you're going to have to follow up with your financial providers to make sure that all the participants in that loan are in agreement of what that convention is.

Tom Hunt:

But it also really looks at the dynamic changes that can happen with the admin agent of the loan transaction, too, right? So you really have to understand not only what their course of action or direction might be, but what their exposure is as well. So if you're one of a thousand or several thousand clients, and your loan is of average size, are you going to get the resources that you need to make those changes in the time that need they need to happen? So jumping on it sooner than later is definitely a well-advised task.

Craig Jeffery:

You're saying get on it sooner or later, but most are taking a wait and see approach. I like that.

Tom Hunt:

Yeah. Yeah, definitely. At the ARRC meeting last week, Tom Wipf is the chair of the ARRC, and he opened the meeting with the comments of, "2020 is going to be a very important year, just because next year, we know that the end point is coming. So let's try and move the industry towards action this year." So paraphrasing his words, it's really important to focus on understanding what you have and what the paths could potentially be for a lot of these instruments.

Craig Jeffery:

Yeah, there's already a pretty significant flow into some of the other base rates, or reference rates. So it'll be interesting to see how long ... if LIBOR does make it to the end of 2021 in an effective manner.

Tom Hunt:

If I was a corporate treasurer, asking that question when I was doing my research to really understand the issue, and it really comes down to the panel banks, the FCA with oversight of how LIBOR is positioned through ICE. And if the panel banks all decide not to submit LIBOR, then basically it's not market representative, right? So it doesn't become a rate that potentially the marketplace can reference, because there's not enough material level of instruments behind it. I think LIBOR was intended to be an interbank lending rate, and if those banks aren't providing submissions to what their borrowing rate would be, or their lending rate to other institutions, then essentially that that marketplace goes away. And I think that's the bigger concern. So I've, it becomes determined that LIBOR doesn't have a material showing of the industry, then that's where a lot of this pushes into trying to find alternative rates.

Craig Jeffery:

The farthest the finish line can be out as the end of 2021, but it could be earlier if that this situation happens. Where do you see the problem on the wait and see approach? Where is this lag happening? Is it just being aware of things? Is it discovering what your exposures are? Is it related to figuring out who your system providers are? Where are you most concerned that these companies are far behind now?

Tom Hunt:

A lot of treasury professionals, they're looking at it from their own perspective, right? And I think their exposure to it, they might seem minor, but in reality, it's compounded just from the standpoint that it's not just between them and their bank. They have to look at all of the underlying exposure behind their banks, right? So their bank probably has interbank exposure. They've got many thousand other clients from the standpoint of having ... just understanding that the timing to act is better in the front end versus trying to do something in the second half of 2020, next year, 2021, just from the standpoint of financial providers might not have the bandwidth, or the lag in terms of responding, and trying to hammer out revisions, and contracts. And things are ... it might be more difficult just from the standpoint of, there's more demand on resources that the banks have and financial providers have, and it's just kind of ... trying to get on the front end of it, and being more proactive.

Craig Jeffery:

Anything else on that, besides the general proactivity? I know you have put out some materials, I guess you said the checklist, but I've also looked at some of the materials you have on what to do to prepare to inventory what your exposures are, and in doing some preparation work. Anything else that would be top of mind to get moving on?

Tom Hunt:

Really assessing what you have, and setting out a path for how to move it forward, I think is really the steps that need to be taken, but doing that sooner than later, because you don't want to be caught in a position where you're having to be reactionary after the fact, right? So you want to have time on your side to be as proactive as you can, but not be in a position where you have to negotiate with customers, or with providers after the fact, when time might be more of the essence, or the terms might not be as favorable to you just from the standpoint of what they might decide to do.

Craig Jeffery:

Yeah, in the rush, what are you going to do at the end? Sure. As we draw to the end of this podcast, I wanted to see if you had any final comments, or thoughts, or things you wanted to say to the audience at large.

Tom Hunt:

No, I just encourage everyone to check out AFP Resources. We'll continue to provide updates on what's going on with LIBOR, especially as we hit certain milestones. Our conference this year, being in Las Vegas, we'll definitely have sessions on LIBOR. As an ARRC member, we're planning to bring in some heavyweight speakers in terms of participants on the ARRC, but also really to provide insight into what's most important to our members, and making sure that we stay relevant and current to basically help our members do their jobs better.

Craig Jeffery:

Excellent. Thank you so much, Tom. And in the episode notes, you'll have a couple of links to some of the resources for AFP. Some of those are in front of the gate for membership. Others, you can easily become a member and get a huge range of additional resources. I know there's a lot on the public site, and there's just a ton of resources. So we'll put those out there, Tom. Thank you so much for chatting with me on LIBOR replacement, and letting us know what the AFP is doing, and what people should be doing.

Tom Hunt:

Absolutely, my pleasure. Thank you very much.

Outro:

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