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Corporate Governance Update

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FED ISSUES GUIDANCE FOR LIBOR TRANSITION PLANNING EXAMINATIONS; IS YOUR INSTITUTION READY?

Last month, in the Federal Reserve Supervision and Regulation Report (April 2021), the FRB followed up on the federal banking regulators' (OCC, FDIC and FRB) November 2020 Joint Statement on LIBOR Transition encouraging banks to transition away from U.S. dollar (USD) LIBOR as soon as practicable and in any event by December 31, 2021. The federal banking regulators' November 2020 Joint Statement followed a July 2020 "Statement on Managing the LIBOR Transition" (which included the NCUA), encouraging their supervised institutions to continue efforts to prepare for LIBOR's discontinuation.

In the report, the FRB stated that a key examination priority is to ensure that its supervised institutions adequately plan to transition away from LIBOR. Therefore, the agency is increasing supervisory attention on transition efforts and examiners will confirm that institutions are adequately planning for the transition. Institutions should be: (i) tracking the number of their LIBOR exposures; (ii) modifying IT systems and models that use LIBOR; and (iii) identifying contracts that refer to LIBOR. Examiners will share findings and may issue recommendations for action if an institution is not making appropriate progress.

Banks that write new LIBOR-based contracts should include robust fallback language and define an alternative reference rate in those contracts that will apply after LIBOR is no longer available. In addition, banks should identify other potential risks related to the change and work to mitigate those risks ahead of the anticipated end to LIBOR.

Federal reserve examiners will evaluate LIBOR-transition preparedness during regularly scheduled examinations in 2021. If necessary, examiners will conduct work at a holding company or its nonbank subsidiary (or subsidiaries) to assess the overall preparedness of the consolidated organization. To the fullest extent possible, examiners must rely on assessments completed by primary supervisors of lead depository institutions in their assessment of a consolidated organization's LIBOR preparedness. The Federal Reserve advises its examiners to invite their state supervisory counterparts to participate in any targeted examinations and, if requested, assist in assessing transition preparedness during state-led examinations. Examiners should also collaborate with other federal regulators as appropriate.

Examiners will review an institution's plan to confirm that it is able to identify and understand its LIBOR exposures, will discuss its plans for addressing LIBOR exposures, and will evaluate whether the institution has a transition plan in place which will apply after December 31, 2021. An institution with exposure to LIBOR and less than $100 billion in total assets should prepare for the LIBOR transition with respect to six key areas.

- ***Transition Planning.*** An institution should plan to transition away from LIBOR-based financial products. Its transition plan's detail and scope should be commensurate with its LIBOR exposures. Institutions with complex products or multiple product lines tied to LIBOR should have plans with greater detail and a project roadmap defining transition timelines and milestones.
- ***Financial Exposure Measurement and Risk Assessment.*** An institution should accurately measure its financial exposures to LIBOR and report them to senior management.
- ***Operational Preparedness and Risk Control.*** An institution should identify any internal and vendor-provided systems and models that use or require LIBOR as an input and, if possible, make necessary adjustments to maintain smooth operation of those systems and models ahead of LIBOR's cessation. An institution should establish a contingency plan in the event that its service provider is unable to deliver a solution in a timely manner.
- ***Legal Contract Preparedness.*** An institution should identify contracts that reference LIBOR. New LIBOR-based contracts entered into before December 31, 2021 should have robust fallback language that includes a clearly defined alternative reference rate that will apply after LIBOR is no longer available. An institution's transition plans should address how it will determine the impact of LIBOR's cessation on its contracts and the steps it will take to modify these contracts prior to LIBOR's cessation.
- ***Communication.*** Commensurate with its LIBOR exposure, an institution should communicate to its counterparties, clients, consumers, and internal stakeholders about the LIBOR transition, making certain to comply with TILA and the prohibition on engaging in UDAP.
- ***Oversight.*** An institution should provide its transition plan to appropriate managers and provide regular status updates to senior management.

For more information on how your financial institution can prepare to transition from LIBOR, search the BCG website for Newsletter articles, Handouts and Monthly Telephone Briefings. In addition, Aldrich & Bonnefin attorneys have been assisting clients by drafting contractual fallback language and providing other expertise to transition from LIBOR. Is your institution ready for the end of USD LIBOR? Contact Mark Aldrich, or Joel Cook at **MAldrich@ABLawyers.com** or **JCook@ABLawyers.com** or with questions.

NCUA Restarts 2020 COVID-19 Interim Final Rule

Last month, the NCUA issued an interim final (April 2021 NCUA IFR) that temporarily modifies certain of its prompt corrective action (PCA) regulations (12 CFR Part 702) to help ensure federally insured credit unions (FICUs) remain operational and able to provide needed financial services during the COVID-19 pandemic. 86 FR 20258.

NCUA IFR Similar to 2020 IFR. The NCUA's May 2020 interim final rule (2020 IFR) addressed two aspects of the agency's PCA regulations. 85 FR 31952. The first amendment addressed the earnings retention requirement in Section 702.201 for FICUs classified as adequately capitalized.

The second amendment addressed the net worth restoration plans (NWRP) required under Section 702.206(c) for FICUs that have become undercapitalized. However these amendments expired on December 31, 2020.

The April 2021 NCUA IFR essentially reinstituted the same two changes to the NCUA's PCA regulations. The April 2021 NCUA IFR was effective upon publication in the Federal Register on April 19, 2021, and temporarily modifies the PCA regulations in two ways: (i) the NCUA was granted temporary authority to issue an order applicable to all FICUs to waive the earnings retention requirement for any FICU that is classified as adequately capitalized; and (ii) the specific documentation needed in connection with an NWRP that an undercapitalized FICU is required to complete is temporarily amended. The April 2021 NCUA IFR will be in effect until March 31, 2022, unless otherwise extended or amended by the agency.

The NCUA decided to renew the temporary relief measures it issued last year because it anticipates that credit unions will receive a significant increase in deposits due to the American Rescue Plan Act of 2021 stimulus checks. According to the NCUA, 2020's stimulus payments deposited with FICUs caused them to experience significant asset growth, which in turn strained some CUs' net worth positions, and negatively impacted many CUs' PCA classification. Specifically, the credit union industry experienced asset growth—predominantly from share growth—at a rate of 17.73 percent from December 31, 2019, to December 31, 2020. During this same period, the number of FICUs with a PCA classification of adequately capitalized increased by 274 percent, and those classified as undercapitalized increased by 123 percent.

Section 702.201 – Earnings-Retention Requirement for "Adequately Capitalized" FICUs. The NCUA temporarily amended Section 702.201 to provide the agency with express regulatory authority to issue a single order waiving the earnings retention requirement for all FICUs classified as adequately capitalized while this temporary rule is in effect. The NCUA intends, as it did in the 2020 IFR, to authorize the applicable regional director to require an application for an earnings transfer waiver if a particular FICU poses undue risk to the National Credit Union Share Insurance Fund, or exhibits material safety and soundness concerns.

Section 702.20(c) – Amended Contents of NWRPs. The April 2021 NCUA IFR also temporarily waived the NWRP content requirements for FICUs that become classified as undercapitalized (those that have a net worth ratio of 4.0 percent to 5.99 percent) predominantly as a result of share growth. In these cases, a FICU may submit a significantly simpler NWRP to the applicable regional director noting that the FICU became undercapitalized as a result of share growth. Specifically, a FICU is required to attest that its reduction in capital was caused by share growth and that this share growth is a temporary condition due to the COVID–19 pandemic and congressional actions to provide stimulus through direct payments to taxpayers. Federally insured, state-chartered credit unions must comply with applicable state requirements when submitting NWRPs for the state supervisory authority's approval. When reviewing an NWRP submitted under this authority, the regional director will determine whether the decrease in the net worth ratio was predominantly a result of share growth.

Refer to Part Four, Section II.M. of SPM 17, *Managing Financial Institutions*, for a complete discussion of the NCUA's PCA Regulations. Paragraph M.1. outlines the PCA regulations in effect through the end of this year. Paragraph M.2. outlines how the PCA regulations will be significantly revised effective January 1, 2022 (unless otherwise postponed as they have been a few times). Contact Mark Aldrich or Joel Cook at **MAldrich@ABLawyers.com** or JCook@ **ABLawyers.com** with questions.