ARRC
Alternative Reference Rates Committee | Newsletter

This periodic newsletter provides an update for those with an interest in the work of the Alternative Reference Rates Committee (ARRC), keeping you well informed on key news relating to alternative reference rates transition in the U.S. and global markets.

August-September 2019

ARRC Developments

- The ARRC released a practical implementation checklist to help market participants transition away from U.S. dollar (USD) LIBOR to using the Secured Overnight Financing Rate (SOFR). The checklist covers 10 key areas where action is needed in order for impacted firms to prepare for the transition to SOFR. These include governance, communications, risk management, contract remediation, and operational readiness.
- The ARRC released the SOFR Floating Rate Notes (FRNs) Conventions Matrix, which identifies considerations relevant to using SOFR in new FRNs and supplements the ARRC's paper, "A User's Guide to SOFR". The matrix is accompanied by the SOFR FRNs Comparison Chart, which outlines conventions already being used in the market.
- The ARRC released minutes from its September meeting, which include a presentation providing preliminary analyses on potential spread adjustment methodologies for cash products for the ARRC's consideration. The minutes also include a presentation on the parameters being considered by the Federal Reserve Bank of New York for its production of SOFR averages and a related index, currently planned to commence in the first half of 2020. The minutes note that the exact timing for the averages and index depends on the feedback received in response to a public consultation, which would be launched soon.
- The ARRC updated its Frequently Asked Questions document to include further information regarding questions about volatility in SOFR (Question 16). The response explains that contracts referencing SOFR have been based on averages of the daily rates, which have been quite smooth and can be easily referenced in financial contracts.
- The ARRC's Accounting and Tax subgroup released a letter to the U.S. Securities and Exchange Commission requesting confirmation that equity-classified preferred stock instruments, with dividends or other terms that reference LIBOR, qualify for the same relief that the Financial Accounting Standards Board (FASB) has proposed for contracts referencing interbank offer rates (IBORs), including LIBOR (described below in this newsletter, in the "U.S. Developments" section).

U.S. Developments

- The FASB issued a proposed Accounting Standards Update, Facilitation of the Effects of Reference Rate Reform on Financial Reporting, providing temporary, optional expedients and exceptions to the guidance in U.S. Generally Accepted Accounting Principles for contract modifications and hedge accounting in light of the transition away from LIBOR and other IBORs to alternative reference rates such as SOFR. The purpose of the proposal is to ease the potential burden in accounting for, or recognizing the effects of, reference rate reform on financial reporting. The relief would be effective upon issuance, and entities would be able to apply it prospectively through December 31, 2022. Comments are due by October 7, 2019.

- The U.S. Commodities Futures Trading Commission's (CFTC) Market Risk Advisory Committee (MRAC) approved plain English disclosures for new derivatives referencing LIBOR and other IBORS at its September 9 public meeting. This standard set of disclosures is intended as an example of disclosures that market participants could use with counterparties with whom they continue to transact derivatives referencing LIBOR and other IBORs. The disclosures cover the implications of using such products.
- The CFTC's September MRAC meeting also included a discussion of the CME and LCH proposals for transitioning price alignment interest and discounting for USD-denominated over-the-counter cleared swaps to SOFR, including areas for coordination and risk considerations.
- The U.S. Prudential Regulators published a proposal adopting relief for regulations that require swap dealers and security-based swap dealers to exchange margin with their counterparties for swaps that are not centrally cleared. The proposed rule would permit legacy swaps to retain their legacy status in the event that they are amended to replace an IBOR or other discontinued rate.
- In remarks at the fifth annual U.S. Treasury Market Conference, New York Fed President John Williams highlighted the urgent need to transition away from LIBOR. Per Williams, "There's no one-size-fits-all approach for closing out or converting existing LIBOR positions so market participants need to get ahead of this issue… If your firm is one of those hoping the problem will go away, or feeling nostalgic and counting on an extension to the deadline, take this message back: The clock is ticking, LIBOR's days are numbered."

International Developments

For more details on international efforts for reference rate reform, see the working groups in the U.K., Switzerland, Japan, Hong Kong the euro area, and the Official Sector Steering Group.

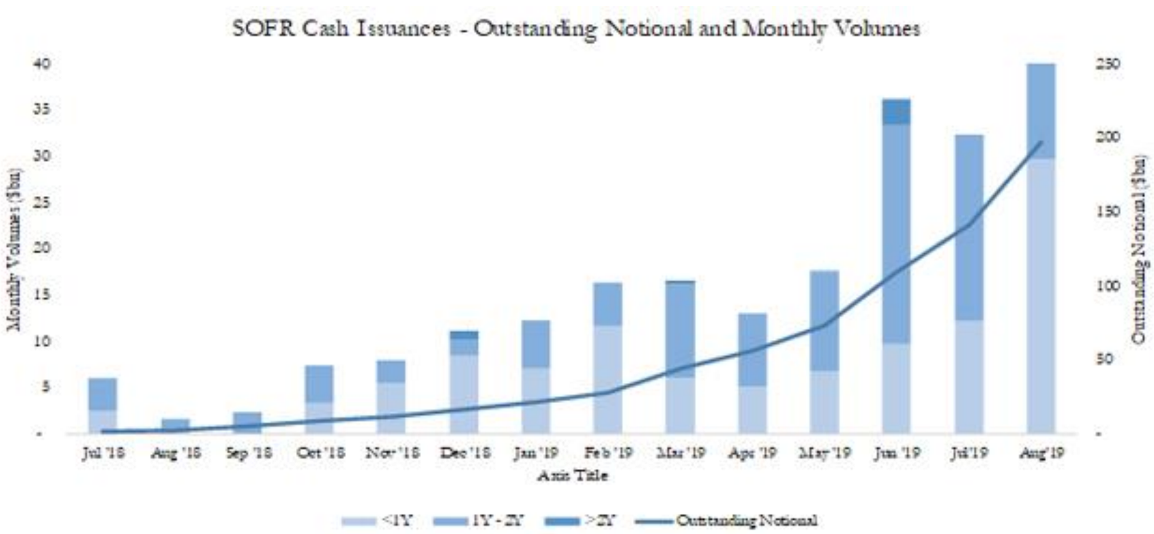
- The European Central Bank's (ECB) Working Group on Euro Risk-Free Rates published a report containing recommendations addressing the impact of the transition from the Euro Overnight Index Average (EONIA) to the Euro Short-Term Rate (€STR). The report analyzes various financial products and processes affected by the transition, including cash products, securities, investment funds, derivatives and models. The report focuses on operational and valuation-specific issues of moving to €STR and provides recommendations aimed to mitigate the risks of the transition.
- The European Money Markets Institute confirmed EONIA will be published using a new methodology starting on October 2, 2019. The announcement came after the ECB's July decision to start publishing €STR starting on October 2, and it began testing publications for €STR this month.
- The Working Group on Sterling Risk-Free Reference Rates published several updates, including:
  - A statement and an aggregated summary of responses to the March 2019 Discussion Paper on the Sterling Overnight Index Average (SONIA) conventions and referencing SONIA in new contracts. The publication provides further information for market participants when referencing SONIA in bonds, loans, and derivatives.
  - The Market Infrastructure subgroup published a Working Paper on Loans Processing to address the operational processing of loans referencing alternative reference rates, focusing on potential enhancements to loans systems for vendors and proprietary system owners.
  - The Market Infrastructure subgroup also published its updated priority list with regard to infrastructure developments for the transition in U.K. markets.
- BMW issued a £250 million SONIA-linked floating rate note, with the interest set nightly and the coupon paid in arrears every three months.
- The Australian Securitisation Forum has been collaborating with the Australian Financial Markets Association to understand the strengths and weaknesses of the 1-month Bank Bill Swap Rate as a viable, robust, interest rate benchmark. Efforts include forming a Working Group with the Asia Pacific Loan Market Association and Finance and Treasury Association aimed at recommending more robust temporary and permanent fallback language for new issues.

Market Developments

- The International Swaps and Derivative Association (ISDA) launched a [new consultation] to finalize the methodologies for the adjustments that will be made to derivatives fallbacks in the event certain IBORs are permanently discontinued. The adjustments reflect the fact that the IBORs are currently available in multiple tenors, but the alternative reference rates identified as fallbacks are overnight rates. The deadline for responses to the consultation is October 23, 2019.
- ISDA published a statement summarizing the preliminary results of a consultation on pre-cessation issues for LIBOR and certain other IBORs based on the 89 responses received since issuing the consultation in May 2019. In September 2019, ISDA hopes to publish an anonymized and aggregated summary of the feedback received and to consult on a proposed documentation solution for derivatives that allows for efficient incorporation of a pre-cessation fallback trigger.
- ISDA's Chief Executive Officer, Scott O'Malia, wrote a letter to the European Commission and the European Securities and Markets Authority in support of an urgent request by Steven van Rijswijk, Chair of the ECB's Working Group on Euro Risk-free Rates to confirm that amendments to existing transactions for benchmark reform purposes would not have the effect of imposing margin or clearing obligations under the European Markets Infrastructure Regulation.
- On September 17, CME Group announced that CME SOFR futures became a trillion-dollar market. Record single-day volume of $670B was traded with $1.17 tn in open interest, in response to the upward pressure in the repo market.
- The CME Group announced it will launch options on 3-month SOFR futures starting on January 6, 2020, pending regulatory review.
- The CME Group also developed a high-level proposal for transitioning price alignment and discounting for USD-denominated over-the-counter cleared swaps from the effective federal funds rate to SOFR.
- The Board of the International Organization of Securities Commissions published the Statement on Communication and Outreach to Inform Relevant Stakeholders Regarding Benchmarks Transition to raise awareness of how an early transition to alternative reference rates, particularly to SOFR, can mitigate potential risks arising from the expected cessation of LIBOR.

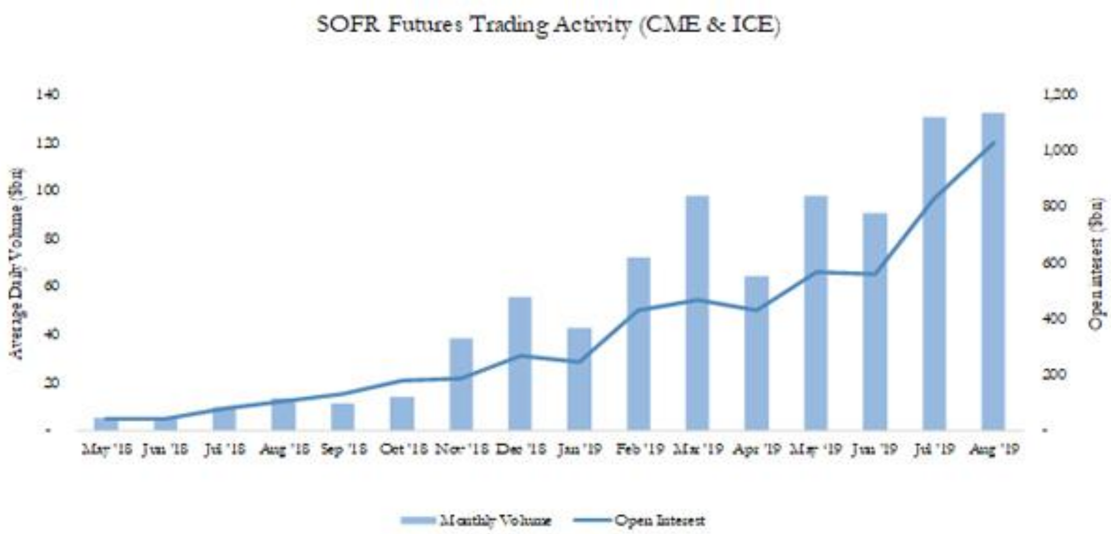
SOFR Market Liquidity

- $236 billion notional in floating rate instruments tied to SOFR have been issued, with over $197 bn outstanding notional at August month-end.



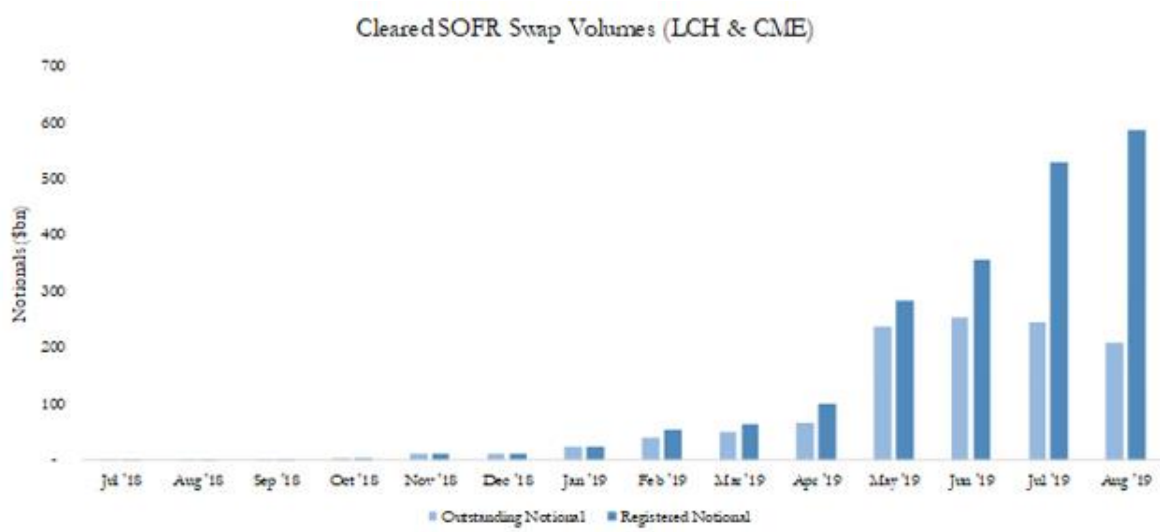
(As of August 31, 2019; Source: CME Group)

- Average daily notional volume and total outstanding open interest of SOFR futures was over $132bn and $1,026bn, respectively, as of August month end.



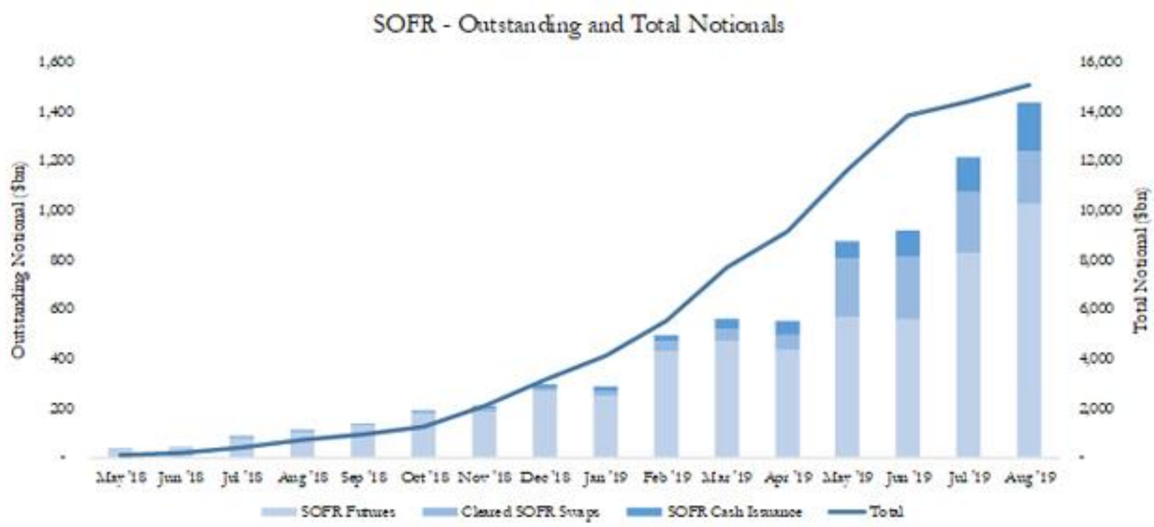
(Source: CME Group, ICE)

- SOFR cleared swaps have reached over $210bn outstanding notional. Combined registered notional volumes across LCH and CME exceeded $586bn.
    - For cleared swaps, outstanding notional represents the notional amount of all outstanding swap contracts live at LCH and CME. Meanwhile, registered notional represents the aggregate notional amount of all new swap contracts submitted to and cleared through LCH and CME.



(Source: LCH, CME Group)

- Since the inception of SOFR in April 2018, total notional across all types of instruments has reached more than $15tn.
  - Total notional refers to the cumulative value of all open and expired SOFR transactions issued to date.



(Source: LCH, CME Group, ICE)

This newsletter is compiled by the ARRC's Outreach and Communications Working Group. If you have any questions please email the ARRC Secretariat at arrc@ny.frb.org.

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