ARRC
Alternative Reference Rates Committee | Newsletter

February - March 2021

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 risk-free rates (RFR) transition in the U.S. and global markets.

Sign up for alerts here

Top 3 Takeaways

1. **The ARRC commended announcements by the Financial Conduct Authority (FCA) and the ICE Benchmark Administration (IBA) regarding precisely when LIBOR will end. In conjunction with previous U.S. supervisory guidance about stopping new U.S. dollar (USD) LIBOR issuances this year, these announcements should accelerate market participants' move away from USD LIBOR.**
    - Publication of the overnight, 1-month, 3-month, 6-month, and 12-month USD LIBOR settings will cease immediately after June 30, 2023.
    - Publication of all 7 euro LIBOR settings, all 7 Swiss franc LIBOR settings, the Spot Next, 1-week, 2-month and 12-month Japanese yen LIBOR settings, the overnight, 1-week, 2-month and 12- month sterling LIBOR settings, and the 1-week and 2-month USD LIBOR settings will cease immediately after December 31, 2021.

2. **The announcements above served to fix the spread adjustments in the IBOR Protocol offered by the International Swaps and Derivatives Association (ISDA). In parallel, the ARRC released a statement confirming that in its opinion, the March 5, 2021 announcements by the FCA and IBA on future cessation and loss of representativeness of the LIBOR benchmarks constitute a "Benchmark Transition Event" with respect to all USD LIBOR settings pursuant to the ARRC recommendations regarding more robust fallback language for new issuances or originations of LIBOR floating rate notes, securitizations, syndicated business loans, and bilateral business loans.**
    - ISDA stated that the March 5 announcements constitute an "Index Cessation Event" under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol, which in turn triggers a "Spread Adjustment Fixing Date" under the Bloomberg IBOR Fallback Rate Adjustments Rule Book.
        - When the panels for all USD LIBOR tenors cease after the end of June 2023 and the fallback rates apply, fallbacks for derivatives under ISDA's documentation would shift to forms of the Secured Overnight Financing Rate (SOFR) plus the spread adjustment that has now been fixed.
        - The ARRC has recommended spread adjustments for fallback language in non-consumer cash products will be the same as the spread adjustments applicable to fallbacks in ISDA's documentation for USD LIBOR.
    - The ARRC also released associated FAQs to address questions including what happens to interest rates under the ARRC's fallback language now that a "Benchmark Transition Event" has occurred and what this means for its recommended spread adjustments.

3. **The ARRC's recent Progress Report and its SOFR Symposium (see "Other ARRC Developments" for more on each), built on ongoing ARRC discussions about a forward-looking SOFR term rate—highlighting both the tremendous progress made in the transition and areas where progress will need to materially accelerate in order for the market to be adequately prepared. The Report showed that *"lack of progress in short-dated trading, which is what any potential term rate would need to be based on, has made it difficult for the ARRC to recommend a term rate,"* and ARRC Chair Tom Wipf noted at the Symposium that "given the current depth of the short-term SOFR derivatives market, we can't provide assurance that the ARRC will be in a position to recommend a term rate by the end of the year." He underscored that the ARRC has already provided a wealth of tools for using SOFR now and encouraged market participants to use those.**

   Following this, the ARRC released an announcement on the term rate, noting that "the ARRC's recommendation of an administrator was always contingent upon certain conditions being met — including the development of sufficient liquidity in SOFR derivatives markets, and developing recommendations for an appropriately limited scope of use for the term rate" and that the ARRC will not be in a position to recommend a forward-forward looking SOFR term rate by mid-2021.
   - The statement further noted that *"the ARRC is still evaluating the limited set of cases in which it believes a term rate could be used"* and it *"cannot guarantee that it will be in a position to recommend an administrator that can produce a robust forward-looking term rate by the end of 2021."*
   - The statement also noted that the ARRC has established a task force to drive the strategy for its term rate work, and in parallel, plans to engage the public in the process.

Other ARRC Developments

- The ARRC released a Progress Report that provides an overview of the transition, including a timeline of concrete steps taken in the transition, a table of remaining LIBOR exposures, and data on the development of alternative markets. The report also offers insight into where progress away from USD LIBOR will need to materially accelerate for the market to be adequately prepared.
- The ARRC convened the first in a series of webinars it will hold, The SOFR Symposium: The Final Year. The first Symposium focused on progress in transitioning away from LIBOR, and areas such as the loan market where progress has been slower.
  - The event opened with remarks by Fed Vice Chair Quarles, who urged market participants to stop using LIBOR. He noted, *"Market participants have had many years to prepare for the end of LIBOR, yet over the last few years they have actually increased use of LIBOR… that must obviously change this year—that's just the laws of physics—and the firms we supervise should be aware of the intense supervisory focus we are placing on their transition, and especially on their plans to end issuance of new contracts by year-end."*
  - The event also included a moderated discussion by chairs of the U.S. and UK working groups, ARRC Chair Tom Wipf and Sterling Working Group on Risk-Free Reference Rates Chair Tushar Morzaria; a presentation by Federal Reserve Board Senior Advisor David Bowman about using SOFR compared to term SOFR; and a discussion with corporate borrowers and banks about how to use existing forms of SOFR in loans now and going forward.
- The ARRC welcomed action by the New York State Legislature to reduce risks associated with the transition away from USD LIBOR by passing Senate Bill 297B/Assembly Bill 164B.
  - This legislation will be crucial in minimizing legal uncertainty and adverse economic impacts associated with the transition—providing greater certainty to investors, businesses, and consumers as the financial system moves away from LIBOR.
- The ARRC announced that it has selected Refinitiv to publish its recommended spread adjustments and spread-adjusted rates for cash products, following a robust request for proposals (RFP) process.
  - Refinitiv will publish ARRC-recommended spread adjustments to SOFR-based rates and spread-adjusted SOFR-based rates for cash products that transition away from USD LIBOR.

- The ARRC released supplemental versions of its recommendation of hardwired fallback language for USD LIBOR denominated syndicated and bilateral business loans. The supplemental recommendation sets out abridged versions of the 2020 fallback language for syndicated business loans and bilateral business loans incorporating the certainty on fallback timing and economics afforded by the March 5th announcements.
  - This language supplements the recommended fallback language for syndicated business loans from June 30, 2020 and recommended fallback language for bilateral business loans from August 27, 2020.
- The ARRC published a white paper that describes a formula to calculate a fallback from the USD LIBOR ICE Swap Rate to a spread-adjusted SOFR Swap Rate.
  - Contracts that are indirectly linked to USD LIBOR through reference to USD ICE Swap Rates are not covered by existing fallback provisions. The paper is intended to facilitate conversations within industry bodies and between counterparties on incorporating robust fallbacks in both legacy and new contracts referencing the USD LIBOR ICE Swap Rate.
- The ARRC published a white paper that outlines a model for using SOFR in asset-backed securities (ABS) products. For the purposes of this paper, it refers to ABS products as collectively representing consumer ABS, mortgage-backed securities, and commercial mortgage-backed securities products.
  - The paper describes how new issuance of ABS products could use 30-day Average SOFR, with a monthly reset, set in advance of the interest accrual period. This methodology uses the actual SOFR rates from the 30-day period before the applicable reset date, which the ARRC determined to be preferable to the alternatives for operational ease.
- Tom Wipf, Chair of the ARRC, participated in a fireside chat discussing critical issues the industry is facing in the transition away from LIBOR. This session was part of the broader EY RMA LIBOR Webinar Series which will continue through April and cover a variety of topics including new product readiness, accounting and finance readiness, client outreach and strategy.

U.S. Developments

- The Board of Governors of the Federal Reserve System issued SR 21-7: Assessing Supervised Institutions' Plans to Transition Away from the Use of the LIBOR *"to assist examiners in assessing supervised firms' progress in preparing for the transition,"* with examination work tailored to the size and complexity of the firms' LIBOR exposure. SR 21-7 states that supervised firms *"should demonstrate progress towards moving away from referencing LIBOR in new products"* and also outlines *"the factors that examiners should consider in assessing six key aspects of transition efforts."* The six key aspects of transition are: (1) transition planning; (2) financial exposure measurement and risk assessment; (3) operational preparedness and controls; (4) legal contract preparedness; (5) communication; and (6) oversight.
  - SR 21-7 follows an Interagency Statement on LIBOR Transition issued on November 30, 2020 which notes that "entering into new contracts that reference LIBOR after December 31, 2021 would create safety and soundness risks" and encourages supervised firms "to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021, in order to facilitate an orderly—and safe and sound—LIBOR transition."
  - Commenting on SR 21-7, Michael Gibson, the Director of Supervision and Regulation of the Board of Governors of the Federal Reserve System said, *"Supervised firms that are not making adequate progress in transitioning away from Libor could create safety and soundness risks for themselves and for the financial system. Examiners should consider issuing supervisory findings and other supervisory actions if a firm is not ready to stop issuing Libor-based contracts by December 31, 2021."*
- Randal K. Quarles, in his capacity as FSB Chair, published a letter updating the G20 Finance Ministers and Central Bank Governors on the FSB's key priorities for 2021, which includes the LIBOR transition as an important financial stability topic.
  - The letter states how the impact of COVID-19 on the financial markets in 2020 shed light upon the weaknesses of LIBOR as benchmark for the global financial markets. The FSB will continue facilitating a smooth transition away from LIBOR to alternative reference rates through 2021.
- The New York Federal Reserve issued a Liberty Street Economics research blog post, "How Competitive are U.S. Treasury Repo Markets?" showing show that the secured funding portion of the repo market is

competitive by demonstrating that trading is not concentrated overall and explaining how the pricing of inter-dealer repo trades is available to a wide range of market participants.
    - The blog authors' analysis indicates that rate-indexes based on repo trades, such as SOFR, reflect a deep market with a broad set of participants.
- The Department of Housing and Urban Development issued Mortgagee Letter 2021-08, which removed approval for use of LIBOR in adjustable interest rate HECMs and replaced it with established acceptance of SOFR. The Office of the Comptroller of the Currency published a self-assessment tool for national banks and federal thrifts to use "to evaluate their preparedness for the expected cessation" of LIBOR. The three-page "tool" poses a series of questions for each bank to answer in a self-assessment. These questions can be used to assess the appropriateness of a bank's LIBOR transition plan; bank management's execution of the bank's transition plan; and related oversight and reporting.

Market Developments

- The World Bank priced a new USD 600 million 10-year benchmark bond linked to SOFR. The orderbook was oversubscribed and closed with over USD 640 million of interest from about 20 investors.
- Based on market feedback gathered during a consultation, LCH intends to move forward with a consensus approach of converting outstanding LIBOR contracts into corresponding RFR-based contracts in which:
    - LIBOR is replaced by the relevant compounded RFR plus a non-compounded credit spread adjustment in the LIBOR leg;
    - observation and payment dates in that leg will follow the current market standard for the relevant RFR contract;
    - the non-LIBOR leg of the contract is left unchanged;
    - cash compensation is applied to neutralize any small residual valuation difference; and
    - from an operational perspective, the process will involve termination of the LIBOR contract and re-booking as an RFR contract.
- ISDA released an update on its ISDA-Clarus Risk-Free Rate (RFR) Adoption Indicator. The indicator tracks how much global trading activity is conducted in cleared over-the-counter (OTC) and exchange-traded interest rate derivatives referencing ARRs across six major currencies.
    - In February 2021, the percentage of trading activity in ARRs increased to 10.6% and the percentage of trading activity in SOFR decreased to 5.1% of total USD, compared to January 2021.
- CME Group released reports on monthly market statistics. The February report highlighted a record SOFR futures monthly average daily volume of 123,000 contracts. CME also reported a single-day volume record of 265,511 contracts on February 25, surpassing the previous record of 240,288 contracts on November 19, 2020. SOFR futures open interest also set a record of 757,943 contracts.
- Enbridge Inc. became the first non-financial issuer to launch a SOFR-linked debt offering. The orderbook was six times oversubscribed.
    - Commenting on the landmark issuance, ARRC Chair Tom Wipf said: "As market participants move away from Libor, we can expect a deterioration in Libor liquidity, and so we encourage everyone to prepare for the inevitable by moving to SOFR now."

International Developments

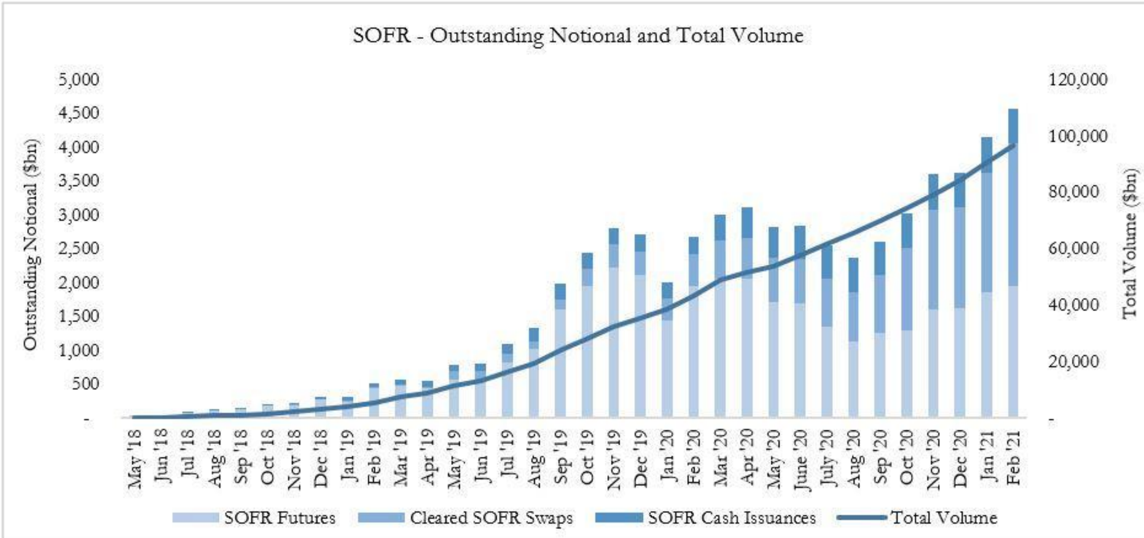
For more details on international efforts for reference rate reform, see the working groups in the U.K., Switzerland, Japan, Hong Kong the euro area, and the Official Sector Steering Group.

- The Working Group on Sterling Risk-free Reference Rates released several updates including:
    - A consultation on a successor rate for legacy bonds referencing GBP LIBOR. The Working Group is seeking feedback on whether to recommend a successor rate and what that rate may be. The consultation closed March 16, 2021.
    - A paper supporting the transition of non-linear derivatives referencing GBP LIBOR ICE Swap Rate. The paper includes a potential methodology using Sterling Overnight Index Average (SONIA).

  - A path to ceasing new GBP LIBOR-linked derivatives. The paper includes steps to help market participants transition, including stopping new GBP LIBOR-linked issuances by the end of March 2021 in most circumstances.
  - A Questions and Answers document addressing questions market participants may have when preparing to cease new issuance of GBP LIBOR-linked loans by the end of March 2021.
  - A Best Practices guide for GBP loans maturing post 2021. The guide consolidates previously published information regarding the loan conventions for new GBP SONIA issuances and legacy GBP LIBOR.
- The National Working Group on Swiss Franc Reference Rates published a Rate Switch Amendment Agreement to standardize amendment agreements for syndicated CHF single currency credit facility agreements. The group also recommends the following:
  - Market participants and applicable clearing houses switch bilateral CHF LIBOR-based derivatives to Swiss Average Rate Overnight (SARON)-based derivatives before the end of 2021.
  - A common approach for CHF hybrid bonds with reset dates beyond 2021.
- The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks responded to the FCA's November 2020 consultation on a proposed policy with respect to the exercise of the FCA's powers under new Article 23D which helps the FCA manage an orderly wind-down of critical benchmarks which are no longer representative. The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks supports the FCA's proposal. The use of Article 23D powers would facilitate the phasing out of Japanese Yen LIBOR in Japan considering there are still transition risks and uncertainties.
- The Steering Committee for Singapore Dollar Swap Offer Rate (SOR) and Singapore Interbank Offered Rate (SIBOR) Transition to SORA released several updates including:
  - Keynote speech by Monetary Authority of Singapore Deputy Managing Director at virtual event on Singapore IBOR Transition, hosted by Asia Securities Industry & Financial Markets Association in collaboration with The Association of Banks in Singapore.
  - A transition roadmap to further advance the industry transition to a SORA centered Singapore Dollar interest rate market by before the end of 2021.
  - An announcement regarding the extension of central clearing for OTC SORA derivatives by LCH from 5.5-years to 21-years to help build liquidity and support the transitioning of SOR derivatives to SORA.
- The Working Group on Euro Risk-Free Rates released several updates including:
  - Summary of responses to the public consultation on EURIBOR fallback trigger events. The majority of respondents agreed with the proposals regarding EURIBOR fallback trigger events.
  - Summary of responses to the public consultation on Euro short-term rate (€STR)-based EURIBOR fallback rates. Most respondents agreed with the proposals regarding €STR-based EURIBOR fallback rates. However, respondents were split between the forward-looking and the backward-looking lookback period methodologies as the appropriate EURIBOR fallback for investment fund benchmarks. In terms of the spread adjustment, about half of the respondents disagreed with the proposed transition period of one year for some cash products.
- The Canadian Alternative Reference Rate working group welcomed the issuance of the first CORRA compounded in arrears floating rate note. The Royal Bank of Canada issued the $500 million 1-year note referencing CORRA compounded-in-arrears.

SOFR Market Liquidity

Since SOFR's publication in 2018, approximately $939bn notional in floating rate debt tied to SOFR have been issued, with over $508bn outstanding notional at February month-end.



As of February 28, 2021
Source: CME Group, LCH, ICE
Note: Cleared SOFR swaps figures represent one side of each transaction (single-sided)

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.

https://www.newyorkfed.org/arrc