The Alternate Reference Rate Committee (ARRC)
Federal Reserve Bank of New York
United States of America

November 26, 2018

Credit Suisse Group (CS) hereby submits our response to the Floating Rate Note (FRN) consultation paper published by the ARRC on September 24, 2018. This letter is intended to highlight our general recommendations for a safe transition to SOFR and other proposed alternate reference rates, as well as to answer the 13 questions laid out within the ARRC paper.

CS believes that in principle, an optimal approach for Reference Rate and Spread determination for FRNs must:

a. Minimize the potential for market manipulation by any group of note market participants, regardless of the timing of the trigger event.
b. Be synchronized, or at least compatible with, developing fallbacks in other related markets (e.g. Derivative and Loan instruments)
c. Minimize interpretation risk, by using accessible data and deterministic terms. This should allow issuers, marketers and even unsophisticated investors to independently and quickly arrive at fallback terms without the need for external counsel.
d. Be practical to implement across systems, entailing reasonable implementation overhead and complexity.
e. Minimize the possibility of value transfer at the point of transition, or perceived economic harm on parties, so as to reduce legal and litigation risks.
f. Minimize event risk by limiting impacts from global monetary policy decisions on or around the day of the fallback being triggered.

While the fallback terms proposed in your paper are specific to the SOFR rate alone, we believe it essential to align these provisions across all the globally identified alternate reference rates (i.e. across currencies). This will minimize the disruption of liquidity and funding management practices, particularly for large issuers that must deal with investors across multiple global debt markets. Standardization of approaches will also serve to minimize cross-currency basis risk, thus saving potential hedging costs. Further, a simplified approach across currencies would reduce implementation costs and complexity for all parties.

Similarly, the alignment of fallbacks agreed for FRNs with those of Derivative and Loan markets is important. This is because at large issuers like CS, debt issuances are often closely tied to Derivative hedges as well as factor into the internal cost of funding for our lending activities to clients. Further, if a transition point to alternate reference rates is clearly defined and communicated across markets sufficiently in advance, it would minimize the time it takes for both the asset (e.g. loans) and liability (e.g. notes) sides of firms' balance sheets to transition to their new valuations.

Finally, within the 'Replacement Benchmark Waterfall' proposed in the consultation, CS is opposed to Step 3 which uses 'Spot SOFR rate + Spread'. Such a provision, if incurred, would materially expose contract parties to monetary policy developments on or around the actual day of fallback (e.g. a steep interest rate hike). In our opinion this presents a high risk of market manipulation or allegations thereof, and may lead to disputes between FRN issuers and investors. This recommendation is consistent with our comment letters on the Derivatives and Loans fallback consultations.

Q1: Pre-cessation Triggers

Q1(a): Should fallback language for FRNs include any of the pre-cessation triggers (triggers 3, 4 and 5)? If so, which ones?

- Trigger 3: events that signal an unannounced stop to LIBOR: failure to publish for 5 days
- Trigger 4: a material change in LIBOR: insufficient submissions
- Trigger 5: shift in the regulatory judgment of the quality of LIBOR that would likely have a significant negative impact on its liquidity and usefulness to market participants

A1(a): We believe the inclusion of pre-cessation trigger 5 is helpful, as its determination is made by a regulatory authority, and as such a situation could give rise to market manipulation or allegations thereof. Our concern with trigger 3 is that a failure to publish LIBOR for some days should result in permanent LIBOR discontinuation, not a temporary one, to prevent untimely contractual resets and operational issues. If such a trigger is chosen, we recommend arriving at the 'number of days LIBOR fails to publish' through future industry consultation. Our suggestion for trigger 4 is that such a determination would be best made by a regulatory body that the market recognizes, so it could be aligned to the definition of trigger 5.

Q1(b): Please indicate whether any concerns you have about these pre-cessation triggers relate to differences between these triggers and those for standard derivatives or relate specifically to the pre-cessation triggers themselves.

A1(b): In general, any and all pre-cessation triggers should be simple, deterministic and independently verifiable without reliance on external counsel or calculation agents. With end investors differing in their sophistication and capabilities, disagreements on fallback terms would increase litigation risks. Separately, we are concerned that the recent ISDA consultation for Derivative fallbacks did not propose any pre-cessation trigger events, which would present an apparent departure from ARRC proposals for FRNs and Loans. Additionally, the current ISDA proposal has not fully addressed fallbacks for more complex derivatives, such as Cross-Currency Basis Swaps and Swaptions, which are often tied as hedges to note issuance activity.

Q1(c): If pre-cessation triggers are not included, what options would be available to market participants to manage the potential risks involved in continuing to reference a Benchmark whose regulator has publicly determined that it is not representative of the underlying market or a Benchmark permanently or indefinitely based on a number of submissions that the Benchmark's administrator acknowledges to be insufficient to allow for production in a standard manner?

A1(c): Per our response to earlier questions, we support the inclusion of pre-cessation triggers. To minimize the risks noted, we think it key that FRN fallback standards are agreed across alternate reference rates/currencies and communicated widely sufficiently in advance of the timeframe in which the pre-cessation trigger events may become a reality.

Q2 & 3: Forward Looking SOFR and Compound SOFR

Q2: If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for floating rate notes referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR?

A2: We believe that utilizing published forward-looking term rates of each alternative reference rate would be far preferable to other waterfall steps proposed in the consultation paper. These forward looking term rates could be derived from the developing futures markets in respective ARRs (e.g. SOFR futures) and would make more sense economically while also being simpler to implement. They would also be most intuitive to investors. Published term rates would also make it easier to align rate adjustment methodologies between different products.

Q3(a): Should Compounded SOFR be the second step in the waterfall? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR?

A3(a): Yes. In the absence of a published term rate, a compounded rate is highly preferred to any overnight/spot rate (which we oppose), as it limits exposure to monetary policy developments on or around the day of the fallback event. While fallback terms for FRNs should ideally align with those of Derivatives, choosing an overnight/spot rate as Step 2 or in any step of the waterfall could bring economic consequences for contract parties, based on fallback timing, thereby increasing litigation risks. Therefore our recommendation for FRNs stands regardless of what ISDA chooses for Derivatives.

Q3(b): If you believe that Compounded SOFR should be included, which compounding period is preferable ("in arrears" or "in advance")? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR "in arrears" or "in advance"?

A3(b): We have found the 'compounding in arrears' method to be the most practical of ISDA's proposed approaches for RFR adjustment for Derivatives, given its alignment with existing market conventions for OIS Swaps, relative ease of implementation, and low scope for disagreements between borrowers and lenders. We would prefer an alignment of compounding approaches across products. However, if your consultation determines that different methodologies are necessary and/or such alignment would lead to material market practice disruption, we will stand ready to adopt an approach determined by market consensus.

Q4 & 5: Overnight SOFR and Replacement Rate

Q4(a): Would an overnight rate that remains in effect for the entire interest period be an acceptable option for investors, issuers and agents?

A4(a): No, as the overnight rate observed at the time of fallback may differ materially from that prevalent during coupon payments, particularly in a sharp interest rate hiking or lowering cycle. A term rate would be highly preferable.

Q4(b): Should the waterfall include Compounded SOFR (step 2) and spot SOFR (step 3) and/or a simple average of SOFR (not in the waterfall at this time)? If only one of these options is included, which is preferable? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR?

A4(b): We recommend including Compounded SOFR (step 2) but are opposed to spot SOFR (step 3), for the reasons mentioned in our answers above. If Compounded SOFR is not feasible, an available simple average of historical SOFR would be highly preferable to spot SOFR. Again, this recommendation for FRNs stands regardless of what ISDA chooses for Derivatives.

Q5: In the future circumstance where there is no SOFR-based fallback rate, is the replacement rate determined by the Relevant Governmental Body the best alternative at this level of the waterfall?

A5: Yes, in such a circumstance we would prefer a replacement rate to be determined by the relevant governmental body. This would help avoid litigation risk for issuers by transparently providing for a public authority that is recognized by all FRN market participants (as opposed to private calculation agents or industry actors).

Q6: ISDA fallback

Q6(a): In the future circumstance where there is no SOFR-based fallback rate and the Relevant Governmental Body has not recommended a replacement rate for FRNs, is the fallback for SOFR-linked derivatives set forth in the ISDA definitions the best alternative at this level of the waterfall?

A6(a): No. Such a circumstance would represent an unlikely crisis situation for FRN markets, and we believe a target official central bank determined rate (e.g. OBFR) would be better placed to provide stability to market pricing.

Q6(b): Should this step in the waterfall refer expressly to OBFR and then the FOMC Target Rate rather than refer to the fallback rate for SOFR-linked derivatives in the ISDA definitions (which could change in the future)?

A6(b): Yes.

Q7 through 10: Issuer (or its designee) Determined Rate and Spread

Q7: Should the issuer or its designee have the ability to over-ride the ISDA fallback for SOFR-linked derivatives in the ISDA definitions at this level of the waterfall if it determines that another rate that is an industry-accepted successor rate for FRNs exists at such time?

A7: No. While such a provision is theoretically helpful, in practice it could give rise to allegations of unfair practice due to the exercise of discretion by the issuer or its designee. Due to the unilateral action involved, the overall risk of litigation actions by investors would increase. It would also cause inconsistency in the markets.

Q8: Do you believe that the ARRC should consider recommending a spread adjustment that could apply to cash products, including FRNs?

A8: Yes, to ensure consistency between markets and provide transparency to both issuers and investors in advance.

Q9: Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the spread waterfall when the Unadjusted Replacement Rate is equivalent to the ISDA fallback rate?

A9: Yes, to ensure consistency between derivative and cash markets.

Of the spread adjustments proposed by ISDA for Derivatives, CS has expressed support for the 'Historical Mean/Median Approach'. While not without its own limitations, this approach allows the least scope for market manipulation, uses readily accessible historical data, and is relatively simple to implement in firm systems.

However, the Historical Mean/Median Approach as proposed suggests a simple mean or median on a fixed lookback period. CS has suggested an enhancement where more weightage could be given to more recent observation periods by applying a time decay function (e.g. exponential weighing). This will ensure that any extreme market events from the distant past will wield only limited influence on today's fallback parameters. Similarly any material moves from the recent past will be appropriately emphasized.

Q10: If the ARRC does not recommend a spread adjustment, should the issuer (or its designee) have the ability to determine the spread adjustment (or, if step 2 is applicable, over-ride the spread adjustment for derivatives fallbacks in the ISDA definitions) and select a spread adjustment that would result in a rate that is an industry-accepted successor rate in floating rate notes at such time?

A10: If a regulator or the ARRC does not recommend a spread adjustment, CS will stand ready to support and determine an adjustment for CS-issued debt, if required to only when there is no alternative. We would do this in good faith since if investors don't believe they will receive LIBOR equivalent rates, detrimental price impacts will likely be observed in secondary debt trading markets.

Q11: Responsibility for Calculations

Q11: Whether as issuer or as calculation agent, would your institution be willing to (i) determine whether the proposed triggers have occurred, (ii) select screens where reference rates or spreads are to be found, (iii) make calculations of a rate or spread in the absence of published screen rates, (iv) interpolate term SOFR if there is a missing middle maturity and (v) make the decisions in step 6 of the Replacement Benchmark waterfall and step 3 of the Replacement Benchmark Spread waterfall?

A11:

(i) Yes, as far as the trigger event definitions are deterministic.

(ii) Yes. However, ideally issuers should adopt market standards and announce screens widely so these may be transparently available to investors.

(iii) CS prefers not to, but stands ready to provide a calculation if required to, only when there is no alternative.

(iv) Yes, if such a term SOFR rate is not already available but is required, and as long as the FRN industry can agree an interpolation methodology.

(v) CS prefers not to, but stands ready to make decisions if required to, only when there is no alternative.

Q12 & 13: Other impediments or feedback

Q12: Is there any provision in the proposal that would significantly impede FRN issuances? If so, please provide a specific and detailed explanation.

A12: Within the waterfalls proposed in the consultation, CS is opposed to using Spot SOFR rate. Such a provision, if incurred, would materially expose contract parties to monetary policy developments on or around the actual day of fallback (e.g. a steep interest rate hike). In our opinion this presents a high risk of market manipulation or allegations thereof, and may lead to disputes between FRN issuers and investors.

Q13: Please provide any additional feedback on any aspect of the proposal.

A13: As stated above, uniformity or a broad alignment between FRN fallback terms with those of derivatives or other cash products is a worthy goal, as it would minimize market disruption. While outside the remit of this consultation paper, we also think agreement of accounting and tax treatments across different jurisdictions, as well as timely regulatory coordination to offer reliefs to not penalize (and thus incentivize) the transition to alternate reference rates will provide a boost to the overall industry transition initiative.

Please direct any questions or feedback to Nomita Singh (Managing Director – Head of US Regulatory Affairs) at nomita.singh@credit-suisse.com

Thank you.