

# ARRC

## Alternative Reference Rates Committee | Newsletter

April – May 2020

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.

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### Top 3 Takeaways

- The ARRC [published](#) recommended [best practices](#) that outline key transition milestones that market participants should aim to meet across floating rate notes, business loans, consumer loans, securitizations, and derivatives.** The best practices outline recommended timelines for when robust fallback language should be incorporated, and dates after which no new U.S. dollar (USD) LIBOR-based activity should be conducted. This document [includes best practices for technology and operations vendors](#), with recommended dates to complete enhancements to their product offerings that are necessary to support the Secured Overnight Financing Rate (SOFR). See the latest results from an ARRC vendor readiness survey [here](#). In conjunction with the best practices, the ARRC also updated its [graphical timeline](#) of key transition dates.
  - ARRC Chair Tom Wipf said, *“These best practices... are designed to support all market participants in meaningful and practical ways as they prepare for this fundamental change in the global market infrastructure.”*
  - Federal Reserve Vice Chair for Supervision Randal Quarles said, *“I commend the ARRC for crafting best practices that focus attention on the issues of highest priority in the transition away from LIBOR.”*
  - New York Fed John Williams said, *“The ARRC’s best practices provide a powerful catalyst for the next stage in the transition away from LIBOR. These tangible steps aim to foster strong controls, promote market integrity, and safeguard the financial system.”*
- Prior to publishing the best practices, the ARRC [announced](#) its [key objectives for 2020](#), which aim to advance the ARRC’s work and mission.** The priorities and milestones enumerated in the objectives build on existing work and progress made in the past year toward market readiness and supporting the voluntary adoption of the SOFR.
- The ARRC [announced](#) a recommended spread adjustment methodology for cash products referencing USD LIBOR, following consideration of [feedback received on its public consultation](#).** The recommended methodology is based on a historical median over a five-year lookback period calculating the difference between USD LIBOR and SOFR. For consumer products, the ARRC recommended a one-year transition period to this five-year median spread adjustment methodology.
  - The ARRC also [issued](#) a [supplemental consultation](#) seeking further views on certain technical issues related to spread adjustment methodologies for cash products referencing USD LIBOR. The consultation is open for feedback through June 8.

### COVID-19 Considerations

- The ARRC [updated](#) its Frequently Asked Questions to provide clarity on its views on how the COVID-19 pandemic influences LIBOR's end-2021 expiration date. The new response notes: *"The ARRC continues to focus on the established timeline for the transition from LIBOR. The ARRC recognizes that near-term, interim steps may be delayed given the current economic environment with the global pandemic, but given the latest announcements from the official sector...it remains clear that the financial system should continue to move to transition by the end of 2021."*
- The Financial Stability Board (FSB) published a [letter](#) from its Chair Randal Quarles to G20 Finance Ministers and Central Bank Governors ahead of their meeting on April 15, 2020. The letter emphasizes the transition away from LIBOR remains a key priority for the FSB.
  - The FSB also [published](#) a [summary](#) of its actions taken in response to COVID-19, noting: *"The transition from LIBOR remains a priority as firms cannot rely on LIBOR being produced after end 2021. Benchmark transition will help to strengthen the global financial system."*
- The Working Group on Sterling Risk-Free Reference Rates [released](#) a statement regarding the impact of COVID-19 on the timeline for LIBOR transition plans. The statement reiterated the central point from a previous [joint statement](#) by the Working Group, the UK Financial Conduct Authority, and Bank of England, stating: *"the central assumption that firms cannot rely on LIBOR being published after the end of 2021."*
  - The Working Group's latest statement focuses more narrowly on interim deadlines for certain aspects of sterling LIBOR-transitions. Specifically, it clarifies that the Working Group's original end-Q3 2020 target for stopping all new issuance of sterling LIBOR-referencing loan products that expire after end-2021 will be moved to a target of end-Q1 2021.

## Other ARRC Developments

- The ARRC [released](#) its [recommendation](#) that a voluntary exchange of cash compensation take place between counterparties to certain swaptions referencing USD LIBOR. This compensation is intended to resolve uncertainty associated with the transition from the use of the Effective Federal Funds Rate to SOFR for discounting cleared derivatives.
- The Co-Chairs of the ARRC Outreach/Communications Working Group, submitted a [BankThink article](#) to the American Banker titled, "The Case for Industrywide Use of SOFR." The article underscores the ARRC's diversity and transparency; SOFR's strengths as an alternative reference rate; and the important role of the ARRC's proposed legislation to New York State lawmakers in minimizing legal uncertainty and adverse economic impacts associated with LIBOR transition.
- The ARRC conducted a [webinar](#) to provide an in-depth overview of the [proposal for New York State legislation](#) for LIBOR contracts. The ARRC released these materials to promote broader engagement on the proposal.
- The Chair of the ARRC's Accounting and Tax Working Group sent a [letter](#) to the Securities and Exchange Commission (SEC) regarding accounting issues associated with certain embedded derivatives in connection with the transition to SOFR.
- The ARRC's Floating Rate Notes Working Group released a [statement](#) to provide market participants with information about how the [New York Fed's published SOFR Index](#) may be referenced in floating rate notes. The statement includes structuring considerations as well as a sample term sheet for floating rate notes referencing the SOFR Index.
- The ARRC [welcomed](#) news from the Federal Housing Financing Agency of a LIBOR Transition Playbook published by [Fannie Mae](#) and [Freddie Mac](#). ARRC Chair Wipf said, *"We applaud Fannie Mae and Freddie Mac for publishing their LIBOR Transition Playbook, which demonstrates a clear and forward-looking approach for moving to SOFR. We encourage other institutions to follow this exemplary model the GSEs have set in establishing specific transition plans."* The ARRC also [welcomed](#) Fannie Mae and Freddie Mac's announcements that provided additional details about their adjustable-rate mortgage (ARM) products indexed to the [30-day SOFR Average](#). ARRC Chair Wipf praised *"the significant progress both institutions have made in transitioning the consumer loan market toward SOFR."*
  - Additional details on the announcement are available in the "U.S. Developments" section below.

## U.S. Developments

- [Fannie Mae](#) and [Freddie Mac](#) released a LIBOR Transition Playbook, frequently asked questions, and other resources on newly published LIBOR websites. The Playbook describes key transition milestones and recommended actions for stakeholders to consider as they manage the upcoming transition away from LIBOR. [Fannie Mae](#) and [Freddie Mac](#) also confirmed eligibility, underwriting, and delivery requirements for residential SOFR-based ARMs to provide additional clarity to all stakeholders in the consumer loan market on the transition away from LIBOR. Fannie Mae will accept Single-Family SOFR ARM products beginning August 3, 2020. Additionally, Freddie Mac [confirmed](#) that it will use the 30-day SOFR Average published by the New York Fed for floating rate loans across all product lines. Freddie Mac confirmed that it will begin quoting SOFR-linked floating rate loans by September 1, 2020.
- Ginnie Mae [posted](#) new [updates](#) for LIBOR-based tranches in the agency's multiclass securities issued in its Ginnie Mae Multiclass Securities Guide. For LIBOR classes issued after March 1, 2020, Ginnie Mae will determine if and when a LIBOR transition event occurs; the date on which LIBOR will be replaced for LIBOR Classes; and the applicable benchmark replacement for LIBOR and spread adjustment. The update also adds SOFR as an available index for new issuances of floating rate Multiclass Securities and adoption of the ARRC-recommended fallback provision.
- The U.S. Treasury Department [announced](#) that it plans to issue a Request for Information on the possibility of issuing a SOFR-indexed floating rate note. Treasury plans to issue an RFI to further its understanding of potential demand for such a security and how it might fit into Treasury's goal of financing the government at the least cost over time.
- The Government Accounting Standards Board [issued](#) a new standard designed to assist state and local governments in the transition away from interbank offered rates (IBORs). Statement No. 93, Replacement of Interbank Offered Rates, addresses accounting and financial reporting implications and provides guidance for reporting requirements related to the replacement of IBORs in hedging derivative instruments and leases.

## Market Developments

- LCH launched a [webpage](#) that provides a regular update of SOFR and SARON registration volumes and notional amounts outstanding that are cleared through LCH by month, segmented by tenor buckets.
- ISDA published [an updated timeline](#) for the implementation of IBOR fallbacks.
- The International Accounting Standards Board published a [paper](#) on International Financial Reporting Standards related to IBOR reform and the effects on financial reporting, including proposed amendments to provide relief from the effects of IBOR reform uncertainties on the highly probable requirement and prospective assessments.
- The Basel Committee on Banking Supervision and International Organization of Securities Commissions issued a [statement](#) providing guidance under their framework for margin requirements for non-centrally cleared derivatives. The statement provides that legacy derivatives contracts amended solely to address IBOR benchmark reform do not require application of the framework's margin requirements, but notes that the position may be different under relevant implementing laws.
- The International Swaps and Derivatives Association (ISDA) announcing that, in July 2020, it expects to publish amendments to the 2006 ISDA Definitions to incorporate the pre-cessation and permanent cessation fallbacks for new trades. This decision came from a [report](#) ISDA [published](#) that summarizes the final responses to its consultation on the implementation of pre-cessation fallbacks for derivatives referenced to LIBOR. The results indicate that most respondents support including pre-cessation and permanent cessation fallbacks without optionality or flexibility in the amended 2006 ISDA Definitions for LIBOR and in a single protocol for including the updated definitions in legacy trades.
- Bloomberg published a [rulebook](#) on the final methodologies for the IBOR fallbacks that ISDA expects to implement for certain key IBORs via a Supplement to the 2006 ISDA Definitions and related Protocol. The final methodology is based on the results of four market-wide consultations that ISDA conducted between 2018 and 2020. Bloomberg expects to publish indicative data on a currency-by-currency basis in the coming weeks. Bloomberg and ISDA will also publish additional educational

materials to help market participants understand the IBOR fallback methodologies and how they will be implemented in ISDA documentation.

- LCH released a [summary of feedback](#) from its consultation regarding proposed rule changes about the inclusion of a precessionation trigger into fallback arrangements . Based on the feedback, LCH intends to move forward with the inclusion of an automatic pre-cessionation trigger as proposed, while being cognizant of avoiding unnecessary risks between cleared and uncleared markets.
- LCH also added [further specification](#) to its plans to switch the discounting on all USD-discounted SwapClear products in October 2020.
- The International Accounting Standards Board [proposed](#) amendments to International Financial Reporting Standards about the effects of interest rate benchmark reform on financial statements. These proposed amendments aim to address issues affecting financial statements relating to modifications, hedge accounting and disclosures when changes are made as a result of the reform.
- The first U.S. dollar-Chinese reniminbi cross-currency swap using SOFR took place, with Crédit Agricole and Bank of China [engaging](#) in a \$10 million, one year swap in late April.

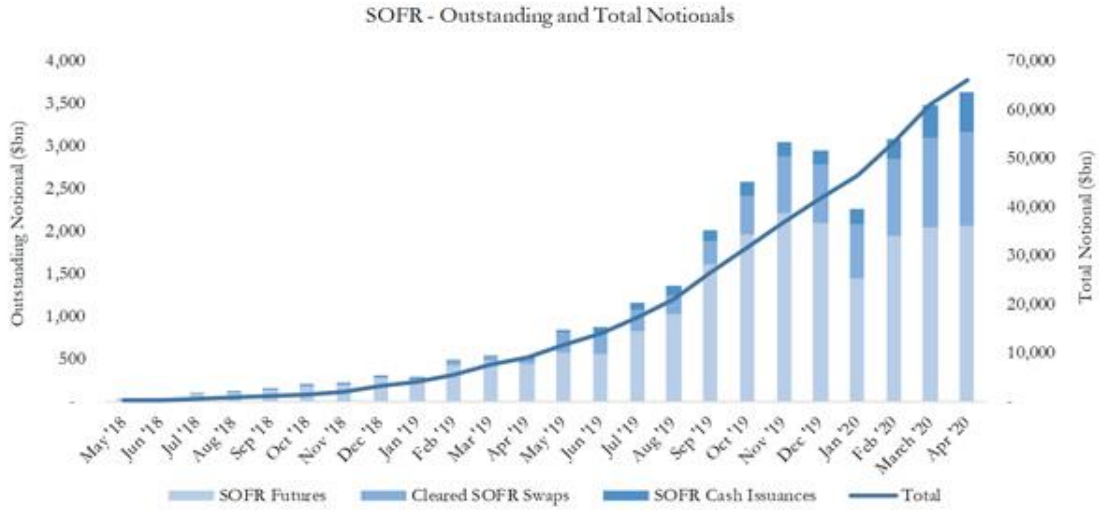
## International Developments

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 Working Group on Euro Risk-Free Rates published a [summary of responses](#) to a consultation on swaptions impacted by the central counterparty discounting transition to the Euro Short-Term Rate (€STR). Based on these responses, the Working Group will evaluate whether recommendations can be derived from the results on how to facilitate the transition to the €STR before the Euro Overnight Index Average is discontinued.
- Banks began offering mortgages tied to the Swiss Average Rate Overnight (SARON), when Switzerland’s largest mortgage lender [began offering](#) its first home loans tied to SARON in mid-April.
- Banks [began offering](#) mortgages tied to the Swiss Average Rate Overnight (SARON), including UBS, St. Galler Kantonalbank, and Luzerner Kantonalbank, which each launched their first SARON-based retail mortgages in May.
- The Hong Kong Monetary Authority (HKMA) [released](#) the results of a survey launched in November 2019 to monitor the banking sector’s progress in preparing for the transition, as well as updates on international and local developments. The survey results are available [here](#).
- The Australian Securities and Investments Commission [released](#) feedback on responses to its [Dear CEO letter](#). The feedback highlights key transition considerations, the importance of preparation and addressing issues early.
- The European Securities and Markets Authority (ESMA), the European Union’s (EU) securities markets regulator, and the Monetary Authority of Singapore (MAS) signed a [Memorandum of Understanding \(MoU\)](#), completing the process to allow the use of Singapore’s financial benchmarks in the EU. Under the MoU, ESMA and MAS will share information and supervisory activities on Singapore-regulated financial benchmarks.

## SOFR Market Liquidity

Since SOFR’s publication, \$601bn notional in floating rate instruments tied to SOFR have been issued, with over \$458bn outstanding notional at April month-end.



(As of April 30, 2020; Source: [CME Group](https://www.cmegroup.com))

*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](mailto:arrc@ny.frb.org) <https://www.newyorkfed.org/arrc>*