ARRC
Alternative Reference Rates Committee | Newsletter

June – July 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 alternative reference rates transition in the U.S. and global markets.

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Top 3 Takeaways

1. **Starting on July 26, 2021, interdealer conventions moved to trade Secured Overnight Financing Rate (SOFR) linear swaps in place of U.S. dollar (USD) LIBOR. The Interest Rate Benchmark Reform Subcommittee of the Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee (MRAC) recommended this move as a market best practice modeled after the "SONIA First" best practice in the U.K., and the MRAC adopted that recommendation soon after.** The ARRC had previously emphasized that it expected its market indicators for a SOFR term rate would be met once the convention switch was in place, allowing the ARRC to formally recommend the CME SOFR term rates very shortly thereafter.

2. **The ARRC announced its formal recommendation of CME Group's forward-looking SOFR Term Rates (SOFR Term Rates) following the successful completion of the SOFR First convention switch in interdealer trading conventions.** The ARRC's formal recommendation of SOFR Term Rates is a major milestone in the transition away from USD LIBOR, providing market participants with an essential transition tool and marking the completion of the Paced Transition Plan that the ARRC outlined in 2017 and has been working toward since.
   - Prior to its formal recommendation, the ARRC announced conventions and use cases for how best to employ the term rates.
     - The announcement noted that the term rates will be especially helpful for the business loans market—particularly multi-lender facilities, middle market loans, and trade finance loans—where transitioning from LIBOR to an overnight rate has been difficult.
     - The Best Practice Recommendations also support the use of SOFR Term Rates in end-user facing derivatives that hedge cash instruments linked to the Term Rates, and certain securitizations with underlying assets that are themselves tied to SOFR Term Rates.

3. **During the Financial Stability Oversight Council (FSOC) Principals Meeting, convened by Treasury Secretary Janet Yellen, the FSOC discussed the importance of accelerating the transition from LIBOR and using sufficiently robust reference rates—like the ARRC-recommended SOFR—for derivatives and capital markets products.**
   - Notably, Federal Reserve Vice Chair Randal Quarles emphasized the importance of timely transition, key progress being made, and the importance by market participants to ensure that they understand any fragilities associated with how their chosen reference rates are constructed.
   - The ARRC welcomed and highlighted messages from the FSOC meeting.

- Edwin Schooling Latter, Director of Markets and Wholesale Policy at the Financial Conduct Authority (FCA), echoed the sentiments and discouraged market participants from using less robust rates during a keynote speech at the UK Finance's Commercial Finance Week, stating: *"We ask that any regulated UK market participants looking to use these so-called 'credit sensitive' rates in UK-based business consider the risks carefully, and raise with their FCA supervisors before doing so."*
- In addition, the Bank of England's recent Financial Stability Report outlined the vulnerability of credit sensitive rates, calling them *"not robust or suitable for widespread use,"* and urged market participants to *"consider the possibility of issues arising in the availability of these rates, to avoid costly changes in the future."*
- Finally, the Federal Housing Finance Agency (FHFA) provided guidance to the Federal Home Loan Banks (FHLBs) regarding the use of alternative reference rates (ARRs). In its supervisory letter, the FHFA noted the considerations FHLBs should address including avoiding rates that (i) are not based on actual market transactions, (ii) introduce unnecessary model risk or (iii) contain similar shortcomings to LIBOR. The ARRC welcomed the letter which encourages the continued use of SOFR and SOFR averages.

Other ARRC Developments

- The ARRC held the third and fourth events in its series of webinars, The SOFR Symposium: The Final Year, on June 8 and July 21. The events built on the ARRC's first and second events in the SOFR Symposium series, by covering the transition from LIBOR to SOFR in the derivatives market and the conditions necessary for a formal recommendation of forward-looking SOFR term rates.
    - The third Symposium, on June 8, featured remarks by Tom Wipf, Chairman of the ARRC; Rostin Behnam, Acting Chairman of the CFTC; Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA; Scott O'Malia, CEO of International Swaps and Derivatives Association (ISDA); Michael Gibson, Director of Supervision and Regulation at the Federal Reserve Board; and other key leaders of the LIBOR transition across the public and private sectors. A recording of the event is available here.
        - In his keynote remarks, Acting Chairman Behnam stressed the need to *"rely on a benchmark that is both representative of transactions and proportional to the depth and breadth of products that rely upon it"* in order *"to avoid the conduct and stability risks that emerged when LIBOR became disconnected from actual activity."*
    - The fourth Symposium, on July 21, featured two panel discussions: the first on the SOFR First initiative, and the second on the ARRC's continued progress towards formally recommending the CME SOFR Term Rates. The panels featured remarks by a variety of leaders in the LIBOR transition, spanning the U.S. and U.K. markets, public and private sectors, and buy- and sell-side perspectives. Speakers included, among others, Nadia Zakir, Chairwoman of the CFTC MRAC and Chief Compliance Officer at PIMCO; Arif Merali, Senior Advisor in the Markets Division at the Bank of England; Alice Wang, Global Head of CIB Operational Risk at JPMorgan Chase; Tal Reback, Principal and Head of LIBOR Transition at KKR; and Agha Mirsa, Managing Director and Global Head of Rates & OTC Products at CME Group. A recording of the event is available here.
        - In his introductory remarks, ARRC Chairman Tom Wipf reiterated that *"SOFR First is the key to delivering Term SOFR."* He added that *"focus, momentum, and support from both the public and private sector"* will be crucial to achieving a successful implementation of SOFR First.
- The ARRC endorsed the CFTC MRAC's recommendation that interdealer trading conventions for cross-currency basis swaps between U.S. dollar, Japanese yen, sterling, and Swiss franc LIBOR move to each currency's risk-free rate (RFR) as of September 21, 2021.

Market Developments

- The International Organization of Securities Commissions (IOSCO) released a statement emphasizing the need to facilitate a successful transition away from LIBOR. IOSCO encourages market participants to discontinue new use of USD LIBOR-linked contracts as soon as practicable and no later than the end of 2021.

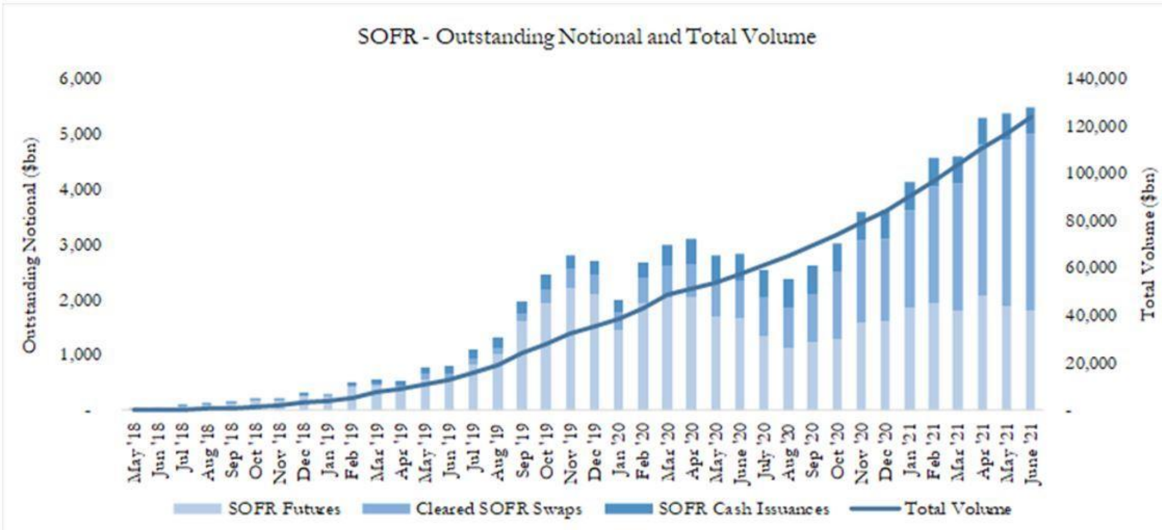
- ISDA launched a consultation on how to implement fallbacks for certain swap rates published by the ICE Benchmark Administration (IBA). While IBA has not consulted on its intention to cease publication of the USD LIBOR ICE Swap Rate immediately after publication on June 30, 2023, ISDA's consultation seeks input to address the potential cessation of ICE swap rates. The consultation closed on July 2, 2021.
- The FCA published a consultation on its proposed decision to use its powers under the Benchmarks Regulation under the Financial Services Act 2021 to calculate the 1-month, 3-month and 6-month GBP and JPY yen LIBOR settings on a synthetic basis post 2021 using a forward-looking term version of SONIA and TONAR, respectively. The deadline of this consultation is August 27, 2021.
- CME Group released several updates including:
    - There was a record SOFR futures and options average daily volume (ADV) of 127K, an increase of more than 200%, in June 2021
    - As of June 30, 2021, the SOFR futures market has 550 participants, YTD ADV of 114K contracts (+154% YoY), and open interest of over 841K contracts (+87% YoY)

International Developments

- The Financial Stability Board (FSB) published multiple documents to support the LIBOR transition, including a statement encouraging regulators to set consistent expectations to facilitate a smooth and timely transition away from LIBOR.
    - Following the FSB's statement, the Financial Services Agency of Japan requested financial institutions to follow the guidance set out by regulators to prepare for the transition away from USD, GBP, CHF and EUR LIBOR. The Australian Securities & Investments Commission, Australian Prudential Regulation Authority and the Reserve Bank of Australia also supported the guidance.
    - The FSB also (i) updated the Global Transition Roadmap to provide market participants with tangible steps to mitigate LIBOR transition risks and facilitate a successful transition by the end of 2021; (ii) published a paper urging market participants to begin offering RFRs now rather than waiting for forward-looking term risk-free rate; and (iii) stated the Official Sector Steering Group's support of the ISDA spread adjustments in cash products.
- The FCA and the Bank of England announced their support for the MRAC recommendation that interdealer trading conventions for cross-currency basis swaps move to RFRs as of September 21, 2021.
- The Working Group on Sterling Risk-Free Reference Rates published a paper to help borrowers accomplish the recommended Q3 milestones to successfully transition legacy GBP LIBOR loans by the end of 2021.
- Beginning on June 17, 2021, market users and liquidity providers in the GBP exchange traded derivatives market are urged by the FCA and Bank of England to switch the default traded instrument from GBP LIBOR to SONIA.
    - Additionally, since May 11, 2021, non-linear derivatives market participants are encouraged to switch from GBP LIBOR to SONIA.
- DBS and Standard Chartered executed the first interbank option trade referencing the Singapore Overnight Rate Average (SORA). DBS and Bunge also executed Singapore's first SOFR export financing transaction.
- The Deputy Governor of Bank of Japan gave a speech at the NIKKEI Financial Online seminar regarding the transition of LIBOR to ARRs. The Deputy Governor called for an acceleration of the LIBOR transition by ending new transactions referencing yen LIBOR and reducing the amount outstanding of legacy and bonds referencing yen LIBOR.

SOFR Market Liquidity

Since SOFR's publication, approximately $1,049bn notional in floating rate instruments tied to SOFR have been issued, with over $501bn outstanding notional at June month-end.



As of June 30, 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]()