ARRC
Alternative Reference Rates Committee | Newsletter

August - September 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 and global markets.

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Top 3 Takeaways

1. **The International Organization of Securities Commissions (IOSCO) released a statement on credit sensitive rates, highlighting the importance of choosing alternative financial benchmarks that are compliant with the IOSCO Principles.**
   - In particular, IOSCO noted, *"Regulators are concerned that some of LIBOR's shortcomings may be replicated through the use of credit sensitive rates that lack sufficient underlying transaction volumes…Therefore, Benchmark administrators of credit sensitive rates should consider how their benchmarks would continue to meet Principles 6 and 7 over time if use of that benchmark became widespread… Widespread use of and transition to credit sensitive rates, instead of the US Alternative Reference Rates Committee's preferred Secured Overnight Financing Rate (SOFR), may therefore pose risks to financial stability... SOFR provides a robust rate suitable for use in most products, with underlying transaction volumes that are unmatched by other alternatives."*
   - The statement quoted New York Fed President John Williams, who said, *"Compliance with all of the IOSCO Principles—consistently over time—is essential to a successful and lasting transition from LIBOR. With this in mind, market participants should now be moving to robust reference rates like SOFR to avoid jeopardizing financial stability."*
   - Speaking at the ARRC's fifth session of The SOFR Symposium: The Final Year (see below), Securities and Exchange Commission (SEC) Chair Gary Gensler drew attention to the IOSCO statement, especially its counsel that "[b]enchmarks which are used extensively must be especially robust." Chair Gensler noted that he did not "believe BSBY [the Bloomberg Short-Term Bank Yield Index] is, as FSB urged, 'especially robust,'" adding that, "I don't believe it meets IOSCO's 2013 standards."

2. **Following the successful completion of the first phase of the "SOFR First" initiative, which saw interdealer conventions transition to trade Secured Overnight Financing Rate (SOFR) linear swaps in place of USD LIBOR, and the ARRC's formal recommendation of term SOFR, SOFR use has ticked up dramatically. According to Clarus data, SOFR trading now accounts for 30% of the USD market.**
   - Starting on September 21, 2021, interdealer trading conventions for cross-currency basis swaps between U.S. dollar (USD), Japanese yen (JPY), sterling and Swiss franc (CHF) LIBOR moved to each currency's risk-free rate (RFR). 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. The ARRC, Bank of England, U.K. Financial Conduct Authority (FCA) and others showed support for the "RFR First" move of interdealer cross currency swap market trading conventions.
   - Media coverage has highlighted significant developments related to SOFR pickup in the loan market. The Financial Times reported that a syndicate led by Bank of America was marketing a $3.25bn financing package tied to SOFR to fund the $4.5bn takeover of chicken producer

Sanderson Farms by Cargill and Continental Grain. Bloomberg reported that Ford Motor Company was refinancing three revolving credit facilities tied to SOFR.

3. **The Treasury Department, Federal Reserve, SEC and CFTC published a response to a letter from the Center for Capital Markets Competitiveness at U.S. Chamber of Commerce regarding LIBOR transition concerns. The Treasury, Federal Reserve, SEC and CFTC reiterated the importance of financial institutions offering LIBOR alternatives, such as SOFR, as soon as possible to meet the needs of borrowers seeking loan agreements.**

Other ARRC Developments

- The ARRC held the fifth and final event in its series of webinars, *The SOFR Symposium: The Final Year*, on September 20, 2021. The event built on the ARRC's SOFR Symposium series (see recordings from Parts I, II, III and IV), by covering the transition to SOFR from the perspectives of the SEC and buy-side institutions.
    - The fifth Symposium featured remarks by SEC Chair Gary Gensler, who discussed lessons learned on reference rates and the outlook on the transition away from LIBOR. This was followed by a discussion featuring leadership from the buy-side on their experience transitioning away from LIBOR, how SOFR supports their efforts and the impacts of U.S. supervisory guidance about the transition.
    - In particular, Chair Gensler said that SOFR is "a preferable alternative rate" because it is "based on a nearly trillion-dollar market."
- The ARRC released Frequently Asked Questions (FAQs) on best practices related to the scope of use of the CME SOFR term rates (SOFR Term Rate). This update follows the ARRC's formal recommendation of the SOFR Term Rate. The FAQs cover general questions about the scope of use, including why the recommendations were made, and more specific questions, such as the use of the SOFR Term Rate in end-user facing derivatives.
- Refinitiv launched a prototype publication of the ARRC's recommended spread adjustments and spread adjusted rates for cash products. The launch follows the ARRC's March 2021 announcement that it had selected Refinitiv to publish LIBOR cash fallback spreads and rates. The initial prototype will not have fallbacks based on the SOFR term rate, but Refinitiv will include them in a second iteration based on the ARRC's recommendation of the CME term rates.
- ARRC Chairman Tom Wipf authored an opinion-editorial in *The Banker*, "Market participants must act now as US Libor ends," which highlights that market participants now have all the tools they need to transition in a way that is safe and smooth for their institutions and for financial markets overall, and that ensures we never have to repeat this reference rates transition again. The piece also highlights the ARRC's priorities through end of year, including:
    - No new LIBOR: Write contracts based on forms of SOFR
    - Fix legacy contracts where possible: Use fallback language or renegotiate contracts where possible
    - Support federal legislation: Critical safe harbor for contracts without effective fallbacks
- The ARRC's Accounting/Tax Working Group released a comment letter to the Treasury on alternatives to the fair market value requirement. The ARRC is seeking clear and timely final regulations to facilitate a smooth market-wide LIBOR transition.
- The ARRC's Securitization Working Group released a supplemental update to its recommended contractual fallback language for USD LIBOR securitizations. The supplemental update amends the definition of a Benchmark Trigger Event within the recommended fallback language to acknowledge its occurrence as a result of the March 2021 ICE Benchmark Administration (IBA) and the FCA announcements.

U.S. Developments

- Part III of the ISDA Benchmark Strategies Forum featured a speech by Michael Held, General Counsel at the New York Fed, and panel participation by Nathaniel Wuerffel, Senior Vice President in the Markets Group at the New York Fed.
    - In his remarks, Held stressed the urgency of transitioning away from LIBOR before year-end: " By the end of this year—a little over three months away—every firm needs to have stopped using LIBOR for all new exposures, and landed safely on robust alternatives. That's not only a recommendation or best practice, it's explicit supervisory guidance."
- The Office of the Comptroller of the Currency (OCC) published congressional testimony by Acting Comptroller Michael Hsu which includes LIBOR transition expectations for supervised banks and demonstrates the OCC's support of SOFR as a LIBOR replacement rate. If banks choose to use other replacement rates, they are expected to fully analyze the appropriateness as OCC examiners will be evaluating the robustness of the chosen rates.
- The Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 20-26 to remind firms of the importance of being adequately prepared for the LIBOR transition. To help market participants evaluate their preparedness, FINRA provided considerations based on results of a survey conducted with member firms.

Market Developments

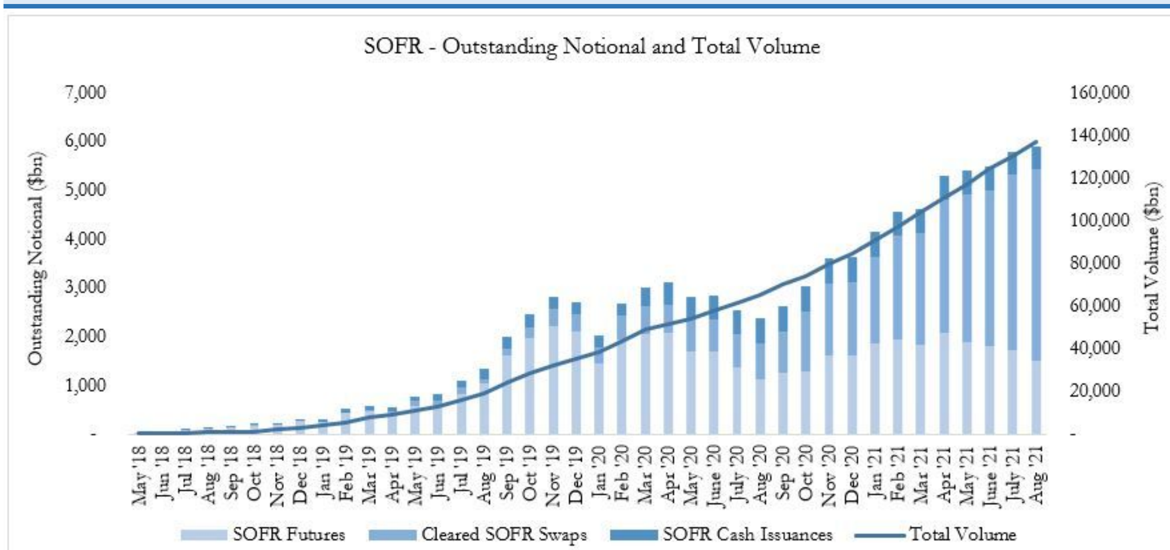
- The Loan Market Association published practical guidance for the documentary amendment process when transitioning legacy LIBOR syndicated loan facilities to compounded risk-free rates. While the guidance is not exhaustive, it identifies key factors to help market participants facilitate and streamline the amendment process.
- LCH transitioned the Price Alignment Interest and Price Alignment Amount from Singapore Swap Offer Rate (SOR) to Singapore Overnight Rate Average (SORA) in applicable SwapClear contracts as of August 9, 2021. LCH also began using SORA-based instruments for discounting in place of SOR.
- IBA announced it will cease the publication of the GBP LIBOR ICE Swap Rate on December 31, 2021. This follows the consultation launched in May 2021 which sought feedback from market participants regarding the potential cessation of GBP LIBOR ICE Swap Rate for all tenors. The US LIBOR ICE Swap Rate, EUR ICE Swap Rate and other ICE Swap Rate settings are not impacted by this announcement.
- ISDA published the *ISDA 2021 European overnight index average (EONIA) Collateral Agreements Fallbacks Protocol* to assist with amending the terms of certain ISDA collateral agreements. Market participants can use the protocol to have legacy EONIA contracts fallback to the euro short-term rate (€STR) plus 8.5 basis points when EONIA is discontinued.
- ISDA released updates on its *ISDA-Clarus Risk-Free Rate Adoption Indicator*. The indicator tracks how much global trading activity is conducted in cleared over-the-counter and exchange-traded interest rate derivatives referencing RFRs across six major currencies.
    - In August, the indicator increased to an all-time high of 17.5% compared to 14.1% in July. On a traded notional basis, RFR-linked interest rate derivatives decreased to $13.5 trillion versus $15.7 trillion the prior month.
- CME Group reported August 2021 statistics, including a 195% rise in average daily volume of SOFR futures.

International Developments

- The UK government introduced the *Critical Benchmarks (References and Administrators' Liability) Bill* to the UK parliament which proposes legislation for safe harbor provisions to support the wind-down of critical benchmarks.
- The European Commission issued and closed consultations on two interest rate initiatives:

    - Statutory replacement rate for CHF LIBOR which follows a consultation conducted earlier this year to assess the suitability of designating a statutory replacement for certain settings of CHF LIBOR
    - Statutory replacement rate for the EONIA benchmark which replaces EONIA with €STR in contracts and financial instruments as referred to in Article 23a of the Benchmarks Regulation.
- The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks released multiple updates, including:
    - The Committee responded to the FCA's *Consultation on proposed decision under Article 23D Benchmarks Regulation for 6 sterling and yen LIBOR settings*, supporting the FCA's decision to use Article 23D powers to help the JPY LIBOR transition.
    - The Working Group on Currency Swaps released a statement supporting the CFTC's Market Risk Advisory Committee's recommendation that interdealer trading conventions for cross-currency swaps involving CHF, GBP, JPY and USD LIBOR move to each currency's respective RFR starting on September 21, 2021.
- The Association of Banks in Singapore updated its *Timelines to Cease Issuance of SOR and SIBOR-Linked Financial Products* document published earlier this year. The documented now incorporates clarification on the wind-down recommendations for SOR derivatives and exposures, as well as FAQs on ceasing new SOR-linked and SIBOR-linked loans.
- The Hong Kong Monetary Authority (HKMA) issued a circular outlining the exceptional circumstances in which banks can continue to issue new USD LIBOR-linked contracts after 2021. HKMA has required authorized institutions to cease entering new LIBOR contracts after 2021 but acknowledges certain risk management related exceptions.
- The Australian Taxation Office (ATO) sought feedback from market participants on the common tax implications of the LIBOR cessation and other aspects of IBOR reform. The ATO will use the feedback to provide advice and guidance.

SOFR Market Liquidity



As of August 31, 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.

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