ARRC
Alternative Reference Rates Committee | Newsletter

October – November 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 transitions in the U.S. and global markets.

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Top 3 Takeaways

1. The ARRC released a "time to move" recommendation urging that all market participants act now to slow their use of U.S. dollar (USD) LIBOR and leverage October and November as a key window to reduce such activity to promote a smooth end to new LIBOR contracts by the end of the year.

- The recommendation referred back to supervisory guidance encouraging banks 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.
- The recommendation noted that *"Proactively slowing new use of LIBOR will support firms' efforts to safely meet the supervisory guidance as they enter the final months of the year, during which resource limitations and potential constraints on systems changes and testing may exist due to year-end deadlines. The ARRC believes that taking a proactive approach over a period of time, rather than at a defined end point under which prevailing liquidity conditions could have an outsized impact, is in the interest of market participants seeking to end new use of USD LIBOR and to support smooth market functioning."*

2. Following Walker & Dunlop's landmark SOFR-linked leveraged loan sale, the use of SOFR in lending markets has steadily increased, with issuers including Polaris, Traverse Midstream Partners, Draslovka Holding, and Gateway Casinos joining the fray.

- Speaking at the ARRC's sixth event in its SOFR Symposium series (see below), Brian Grabenstein, head of Wells Fargo's LIBOR Transition Office, said the *"vast majority"* of new business in the loans market is tied to SOFR. *"We're seeing very few Libor term sheets coming through," he added. "It really hasn't been anything that's been too much to handle. We're doing regular volumes. We're just doing them on SOFR."*

3. The Interest Rate Benchmark Reform Subcommittee of the Commodity Futures Trading Commission's (CFTC) Market Risk Advisory Committee (MRAC) continued its "SOFR First" initiative to include nonlinear derivatives.

- On November 8, 2021, the third phase of the SOFR First initiative was completed as interdealer trading conventions for USD non-linear derivatives transitioned from LIBOR to SOFR. Early indications suggested the move was successful.
- This follows the July 26, 2021 interdealer conventions transition to trade SOFR linear swaps and the September 21, 2021 interdealer conventions transition to trade cross-currency swaps using Japanese yen (JPY), sterling (GBP), and Swiss franc (CHF) alternative reference rates.
- Intercontinental Exchange (ICE) Benchmark Administration (IBA) launched its USD SOFR ICE Swap Rate for SOFR interest rate swaps and USD SOFR Spread-Adjusted ICE Swap Rate for the non-linear market, marking further progress in the linear swaps market and helping to catalyze the shift in the non-linear market.
- The fourth and final phase of the SOFR First initiative will involve exchange-traded derivatives with timing to be confirmed.

Other ARRC Developments

- The ARRC released a summary of its recommendations to date regarding spread-adjusted fallbacks for contracts referencing LIBOR. This document is intended to provide a singular reference point for market participants to understand the ARRC's current recommendations in relation to its fallback language and to state legislation that references ARRC-recommended fallbacks.
- The ARRC held the sixth event in its SOFR Symposium series on October 26, 2021. The event built on the ARRC's prior webinars (see recordings from Parts I, II, III, IV, and V), by covering the transition from the perspectives of the Office of the Comptroller of the Currency (OCC) as well as banks and borrowers.
  - The event opened with remarks by Acting Comptroller of the Currency, Michael J. Hsu, who discussed the importance of maintaining trust in the banking system during the transition from LIBOR to replacement rates. He stressed that *"SOFR provides a robust rate suitable for use in most products, with underlying transaction volumes that are unmatched by other alternatives."* The full text of his remarks can be found here.
  - This was followed by a discussion featuring leadership from various banks and borrowers on their efforts to prepare for the U.S. supervisory guidance advising banks to end new LIBOR issuances by year-end, and how they are taking the ARRC's recent "time to move" recommendation into account to do so.
- The ARRC welcomed Refinitiv's announcement that its USD IBOR Institutional Cash Fallbacks are now available for immediate use as production benchmarks and that, pending final approvals, its USD IBOR Consumer Cash Fallbacks for 1-week and 2-month settings would launch on January 3, 2022. This update follows the ARRC's March 2021 announcement that it had selected Refinitiv as its chosen provider to publish ARRC-recommended fallback rates for cash products based on SOFR.
- The International Swaps and Derivatives Association's (ISDA) IQ publication released a set of responses from a group of senior policy-makers and industry working group chairs regarding the key challenges that lie ahead as LIBOR is retired. The publication included responses from ARRC Chair Tom Wipf and New York Fed Senior Vice President Nathaniel Wuerffel. Among other points, they noted:
  - ARRC Chair Tom Wipf: *"The SOFR First initiative was a key step toward supercharging growth in SOFR derivatives trading, and we continue to see strong progress on that front. Liquidity in SOFR has increased to the point where it is as good or better than liquidity in LIBOR."*
  - New York Fed Senior Vice President Nathaniel Wuerffel: *"Many firms have been working for years now to prepare for the end of USD LIBOR, and some have established internal dates to slow their use of new USD LIBOR ahead of year-end... Delaying your transition from USD LIBOR could risk financial, operational, and reputational consequences to your firm, and result in you not being well positioned at year-end to meet the supervisory deadline. For those firms still entering new USD LIBOR contracts, my strong recommendation is this: act now to prepare for the end of LIBOR."*

U.S. Developments

- The U.S. Senate Committee on Banking, Housing and Urban Affairs held a hearing on the LIBOR transition, and protecting customers and investors. Witnesses agreed that federal legislation to address LIBOR transition issues for legacy contracts is needed to ensure a safe and effective solution for all 50 states and the District of Columbia.
  - ARRC Chair Tom Wipf was one of the witnesses. In his opening remarks, he noted that the ARRC and its members have *"for some time strongly held the consensus view that legislation addressing legacy LIBOR contracts is an important component of the transition,"* and that the ARRC urges both chambers of the U.S. Congress to pass LIBOR legislation *"as expeditiously as possible,"* because it *"can help to ensure an equal outcome for all Americans."* His full opening testimony is available here.
- The federal financial institution regulatory agencies (i.e., Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, OCC, National Credit Union Administration, and Consumer Financial Protection Bureau), along with state bank and credit union regulators, issued a statement on managing the LIBOR transition.
  - The letter emphasized the need for an orderly transition away from LIBOR and notes, *"Failure to adequately prepare for LIBOR's discontinuance could undermine financial stability and institutions' safety and soundness and create litigation, operational, and consumer protection risks."*

    - The statement also included (1) clarifications of what constitutes a new LIBOR contract after 2021, and (2) considerations for assessing the appropriateness of an alternative rate.
- The OCC published an updated self-assessment tool for banks to evaluate and mitigate potential LIBOR transition risks. The updated self-assessment document includes questions to assess the robustness of potential replacement rates.
- Federal Reserve Governor Randal K. Quarles, gave remarks on the end of LIBOR at the Structured Finance Association Conference. He emphasized that market participants should stop using LIBOR by the end of 2021. He concluded saying, *"Market participants should act now to accelerate their transition away from LIBOR. The reign of LIBOR will end imminently, and it will not come back."*
- The Federal Reserve issued an additional set of frequently asked questions as part of its Supervision and Regulation Letter 21-12, to assist its supervised firms in the transition away from using the LIBOR as a reference rate.
- New York Fed Senior Vice President Nathaniel Wuerffel, also delivered remarks on the transition. He covered the importance of transitioning now to prepare for the year-end supervisory deadline. He also urged market participants to *"choose wisely"* when they decide which alternative reference rate to use, to avoid repeating the transition again.

Market Developments

- ISDA released an updated ISDA-Clarus Risk-Free Rate Adoption Indicator, which increased to an all-time high of 24.5% in October compared to 20.3% the prior month.
- CME Group reported record SOFR futures volume and open interest. SOFR futures contracts reached a record 396,421 contracts on October 18, 2021. SOFR futures open interest reached a record 1,166,016 contracts on October 19, 2021.
- The Financial Stability Board published their annual report which included the LIBOR transition as both a priority and a financial stability risk. The report notes that continued reliance of the global financial markets on LIBOR poses clear risks to financial stability.
- Refinitiv launched the regulated Tokyo Swap Rate for swaps referencing TONAR. Refinitiv is using the Tokyo Swap Rate with a constant spread adjustment to produce prototype Tokyo Swap Rate Fallback settings, with plans to produce a benchmark in 2022.

International Developments

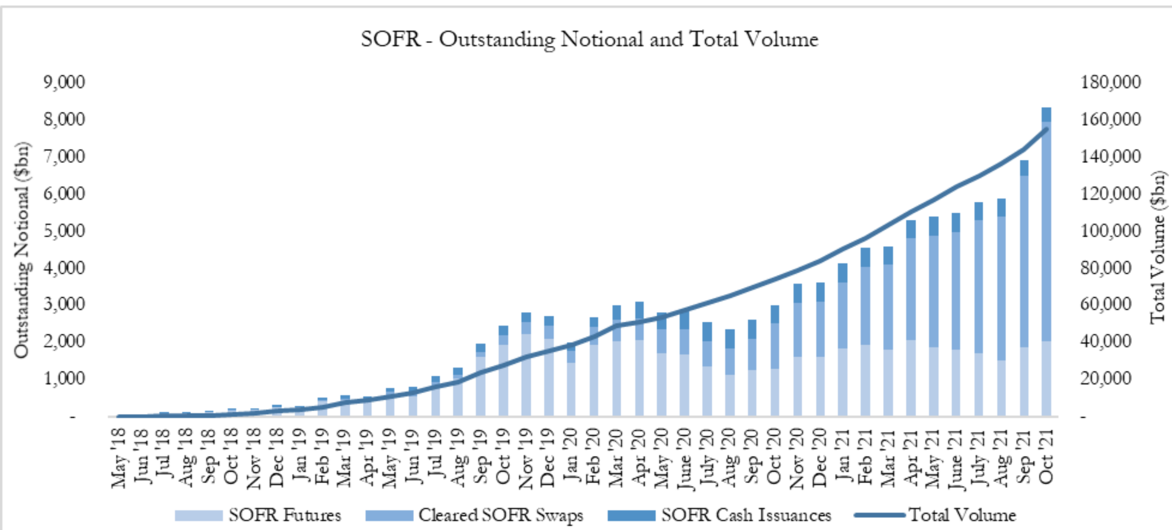
- The Financial Stability Board released a statement to support preparations for LIBOR cessation. The key points covered are that:
    - *"Significant progress has been made in transitioning to Risk-Free Rates (RFRs), but market participants still need to finalize preparations to cease new use of LIBOR by end-2021.*
    - *Transition should be primarily to overnight RFRs, the most robust benchmarks available, to avoid reintroducing the weaknesses of LIBOR.*
    - *Active transition of legacy contracts remains the best way for market participants to have control and certainty over their existing arrangements."*
- The Financial Conduct Authority (FCA) confirmed it will allow the temporary use of synthetic sterling and yen LIBOR rates in all legacy LIBOR contracts, other than cleared derivatives, that have not been changed at or ahead of year-end. In its announcement, the FCA clarified that the synthetic rates would not be available for new contracts, and that the use of USD LIBOR would not be permitted in most new contracts after 2021.
- The Bank of England's Financial Policy Committee published the *Financial Stability in Focus* report on the progress in using alternative reference rates. It emphasized the need to continue using robust alternative reference rates to minimize market disruption during the transition.
- The European Banking Authority published the *Benchmark Rate Transition Risks* report which outlines the importance of the LIBOR transition and risks banks are facing. The report concludes that banks need to act timely to manage potential litigation, reputation, market share, and hedging strategy risks.
- The FCA released several updates, including:
    - A modified list of derivatives subject to the Derivatives Trading Obligation to support the transition from LIBOR.

- A "Questions and Answers" webpage for firms regarding the FCA's new powers under the UK Benchmarks Regulation. The topics covered include impacts on contract provisions and use of synthetic LIBOR.

- Eurex Clearing converted their legacy transactions referencing the Euro Overnight Index Average (EONIA) (worth €364 billion notional) to the euro short-term rate (€STR). The transition to JPY, GBP, and CHF ARRs will occur in December 2021.
- The Bank of Japan published the results of the JPY LIBOR survey which showed that most legacy contracts are expected to transition from JPY LIBOR by the end of 2021.
- The Association of Banks in Singapore published FAQs for the Singapore Swap Offer Rate (SOR) and Singapore Interbank Offered Rate (SIBOR) transition to the Singapore Overnight Rate Average (SORA), including:
    - General FAQs which cover background information on the SOR and SIBOR transition to SORA; and
    - FAQs for Customers which cover specific questions on loans and spread adjustments.

SOFR Market Liquidity

Since SOFR's publication, approximately $1,200 bn notional in floating rate notes tied to SOFR have been issued, with approximately $400 bn outstanding notional at October month-end.



As of October 31, 2021
Sources: CME Group, LCH, ICE, Bloomberg
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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