Alternative Reference Rates Committee
Federal Reserve Bank of New York
New York
United States of America

Email: arrc@ny.frb.org

November 23, 2018

Re: ARRC Consultation regarding more robust LIBOR fallback contract language for new issuances of US$ LIBOR Floating Rate Notes

Dear Sirs,

We applaud the efforts of the Alternative Reference Rates Committee (the "ARRC") to develop recommended contract language to address the transition from US$ LIBOR to SOFR for new issuances of US$ LIBOR floating rate notes. We think that the Consultation Paper is constructive and provides welcomed visibility. We have the following thoughts on the proposals and certain questions posed in the Paper.

Triggers

We support the inclusion of all three pre-cessation triggers, (i.e., "an unannounced stop to LIBOR (trigger 3), a material change in LIBOR (trigger 4), or a 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 (trigger 5)"). While we would prefer to have consistency in the triggers with over-the-counter ("OTC") derivatives, we think that the benefits of including these triggers outweigh the benefits of that consistency, particularly since OTC derivative terms can be negotiated on a bilateral basis, if need be.

Primary Fallback Rate

We support the use of a forward-looking term SOFR rate as the primary fallback rate. We believe this would reassure market participants as it (i) reflects current practice with regard to LIBOR and (ii) benefits both issuers and investors who require knowing the interest rate in effect before the commencement of the interest period. Again, to the extent possible, it would be preferable to have consistency with OTC derivatives.

We would encourage the ARRC to move quickly towards the publication of a robust, liquid forward-looking term SOFR rate in order to aid the transition from LIBOR. We note the Financial Stability Board acknowledged in its July 2018 white paper that use of term rates for certain segments of the cash markets would be compatible with financial stability.

Secondary Fallback Rate

We believe Compounded SOFR should be the second step in the waterfall but suggest the ARRC consider two different waterfalls, one in which the rate is calculated "in arrears" and one in which the rate is calculated "in advance":

- The waterfall with SOFR calculated in advance would follow the current ARRC proposal with Compounded SOFR calculated in advance as the 2nd step and Spot SOFR as the 3rd step.
- The waterfall with SOFR calculated in arrears would have Compounded SOFR calculated in arrears as the 2nd step and Simple Average SOFR as the 3rd step.

ISDA has yet to determine if it will be using Compounded SOFR calculated in advance or Compounded SOFR calculated in arrears so it may be preferable to determine the waterfall based on what ISDA selects. While most issuers would likely want to know the interest rate at the beginning of the interest period and many investors may feel similarly, all of the SOFR bonds issued to date have relied on Simple Average SOFR, which is calculated in arrears. This seems to reflect a genuine issuer and investor appetite which provides an expedient alternative to the ARRC proposal.

Calculating the rate in arrears more accurately reflects actual interest rates over the relevant period. Once ISDA selects its waterfall and term SOFR has become established, the market may migrate toward one of these waterfall approaches. In the meantime, we believe the ARRC should consider either recommending one of these waterfalls based on ISDA's direction or providing for an issuer to choose between these waterfalls based upon its needs. Both waterfalls represent viable alternatives and have their advantages and disadvantages. While establishing a common approach is generally preferable, one size may not initially fit all in these circumstances.

We generally support the remaining proposed steps in the waterfall and therefore answer "yes" to questions 5-7 in the Consultation Paper.

Spread Adjustment

We strongly encourage the ARRC to consider recommending a spread adjustment to apply to cash products (including FRNs), and we support the proposed Steps 2 and 3 in the spread adjustment waterfall (i.e., the spread adjustment approach selected by ISDA (Step 2) and the spread adjustment determined by the issuer or its nominee (Step 3)). We believe an ARRC-published spread adjustment would promote transparency and credibility, and encourage transition for cash market participants.

Issuer Discretion

Discretion can be a sensitive topic with market participants, and we therefore believe any such use should be transparent and well-governed to promote credibility. We encourage the ARRC to provide expressly for the appointment of an independent financial adviser by the issuer. Such an adviser could potentially avoid or mitigate the concerns arising from:

(i) an issuer who uses its discretion to lower the interest rate it pays (or is perceived to have done so) and

(ii) the unwillingness of a calculation agent to exercise the necessary discretion due to the liability risk of being sued by the investors (or the issuer) for its calculation.

It is possible an independent financial adviser would be averse to the same risk as a calculation agent, but an independent financial adviser could be more likely to take that risk, provided that the issuer appropriately compensated the adviser for that risk and indemnified it against that risk. The ARRC may have had the concept of an independent financial adviser in mind when referencing the "the designee" of the issuer in its proposals, but a more explicit recommendation for the use of an independent financial adviser may be justified. This would not be unforeseen by the market. Certain US$ LIBOR bonds issued in the last 3-6 months and many financing arrangements in the international markets (in US$ and other currencies) have provided for the possible appointment of an independent financial adviser. This is a concept that already has a certain amount of market acceptance and credibility, and could be favorably received.

Question 11 asks whether our institution would be willing to take certain actions as calculation agent: we do not normally take on the role of a calculation agent and would generally not choose to do so. On some occasions we act as an independent financial adviser and therefore would consider acting in that capacity.

The Consultation Paper also poses the question whether there is any provision in the proposal that would impede FRN issuances, and we are not aware of any provision that would have such an impact. We would expect the market to start to follow the ARRC proposals once they become final recommendations and the SOFR cash and derivatives markets develop their own common financial conventions (e.g., day count, business day convention and like terms). It will help considerably when ISDA completes its derivatives work and the ARRC publishes its recommendations for other cash products. Finally, we encourage the ARRC to coordinate its efforts and final recommendations regarding contract fallback language with relevant governmental authorities and/or industry bodies in other jurisdictions in order to promote a consistent transition approach even though international convergence may not be possible.