ARRC – FRN Consultation

Question 1(a): Should fallback language for FRNs include any of these pre-cessation triggers? If so, which ones?

R.: We believe the fallback language should not include pre-cessation triggers, as we understand cash products should include fallback language similar to those for standard derivatives in order to avoid any possibilities of arbitrage or basis risk to market participants.

Question 1(b): Please indicate whether any concerns you have about these pre-cessation triggers relate to differences between these triggers and those for standard derivatives or relate specifically to the pre-cessation triggers themselves.

R.: The concerns relate to possible mismatches between cash products and derivatives products. We believe fallback language for both classes of products should be similar, in order to avoid any possibilities of arbitrage or basis risk to market participants.

Question 1(c): If pre-cessation triggers are not included, what options would be available to market participants to manage the potential risks involved in continuing to reference a Benchmark whose regulator has publicly determined that it is not representative of the underlying market or a Benchmark permanently or indefinitely based on a number of submissions that the Benchmark's administrator acknowledges to be insufficient to allow for production in a standard manner?

R.: We believe that if a product was first issued or contracted with an "IBOR" as an index, it should maintain the indexation as long as there is a public available rate, even with the above mentioned considerations. Pre-cessation triggers would only make sense if derivatives products also included them. Changes in the indexation, previous to the permanent cessation of "IBORs" should not be mandatory, but voluntary as an agreement between the parties. We understand that this is more difficult in case of cash products, disseminated with various investors, but the issuer has means to make a consultation using the Clearing System, for example.

Question 2: If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for floating rate notes referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR?

R.: We believe the primary fallback should be the Replacement Rate according to the ISDA Definitions at such time + Spread in order to avoid any possibilities of arbitrage or basis risk to market participants.

Question 3 (a): Should Compounded SOFR be the second step in the waterfall? Would this preference be influenced by whether ISDA implements fallbacks referencing Compounded SOFR ou Overnight SOFR?

R.: We believe the waterfall should be in line with ISDA's implementation, in order to avoid any possibilities of arbitrage or basis risk to market participants. If, however, the primary step is the ARRC recommended forward looking term rate, we understand the secondary fallback should be the Compounded SOFR.

Question 3 (b): If you believe that Compounded SOFR should be included, which compounding period is preferable ("in arrears" or "in advance")? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR "in arrears" or "in advance"?

R.: Our preference is for the "in arrears" methodology; however, our preference would be influenced by ISDA's implementation.

Question 4(a): Would an overnight rate that remains in effect for the entire interest period be an acceptable option for investors, issuers and agents?

R.: No, we believe that it wouldn't reflect the effective rate during the period, as spot rates can be more volatile than they should be and there could also be market manipulation.

Question 4(b): Should the waterfall include Compounded SOFR (step 2) and Spot SOFR (step 3) and/or a simple average of SOFR (not in the waterfall at this time)? If only one of these options is included, which is preferable? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR?

R.: We believe the waterfall should be in line with ISDA's implementation, in order to avoid any possibilities of arbitrage or basis risk to market participants. However, our preference among the alternatives above would be: 1) Compounded SOFR, 2) Simple Average of SOFR and 3) Spot SOFR.

Question 5: In the future circumstance where there is no SOFR-based fallback rate, is the replacement rate determined by the Relevant Governmental Body the best alternative at this level of the waterfall?

R.: We believe the waterfall should be in line with ISDA's implementation, in order to avoid any possibilities of arbitrage or basis risk to market participants. However, considering the steps in the current proposed waterfall, if there is no SOFR-based fallback rate, the replacement rate could be the one as determined by the Relevant Governmental Body.

Question 6 (a): In the future circumstance where there is no SOFR-based fallback rate and the Relevant Governmental Body has not recommended a replacement rate for FRNs, is the fallback for SOFR-linked derivatives set forth in the ISDA definitions the best alternative at this level of the waterfall?

R.: We believe the waterfall should be in line with ISDA's implementation, in order to avoid any possibilities of arbitrage or basis risk to market participants, therefore the fallback for SOFR-linked derivatives set forth in the ISDA definitions should be the first step.

Question 6 (b): Should this step in the waterfall refer expressly to OBFR and then the FOMC Target Rate rather than refer to the fallback rate for SOFR-linked derivatives in the ISDA definitions (which could change in the future)?

R.: We believe the FRN fallback rate should refer to the fallback rate for SOFR-linked derivatives in the ISDA definitions, in order to avoid any possibilities of arbitrage or basis risk to market participants.

Question 7: Should the issuer or its designee have the ability to over-ride the ISDA fallback for SOFR-linked derivatives in the ISDA definitions at this level of the waterfall if it

determines that another rate that is an industry-accepted successor rate for FRNs exists at such time?

R.: Yes, we believe the issuer should have this ability.

Question 8: Do you believe that the ARRC should consider recommending a spread adjustment that could apply to cash products, including FRNs?

R.: We believe the first Step should be the spread adjustment applicable to fallbacks for derivatives under the ISDA definitions, in order to avoid any possibilities of arbitrage or basis risk to market participants.

Question 9: Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the spread waterfall when the Unadjusted Replacement Rate is equivalent to the ISDA fallback rate?

R.: We believe that the spread adjustment applicable to fallbacks for derivatives under the ISDA definitions should be the first step in the spread waterfall. However, considering that the first step is the ARRC recommendation, we agree it is appropriated as the second priority fallback.

Question 10: If the ARRC does not recommend a spread adjustment, should the issuer (or its designee) have the ability to determine the spread adjustment (or, if step 2 is applicable, over-ride the spread adjustment for derivatives fallbacks in the ISDA definitions) and select a spread adjustment that would result in a rate that is an industry-accepted successor rate in floating rate notes at such time?

R.: Yes, we believe the issuer should have this ability.

Question 11: Whether as issuer or as calculation agent, would your institution be willing to (i) determine whether the proposed triggers have occurred, (ii) select screens where reference rates or spreads are to be found, (iii) make calculations of a rate or spread in the absence of published screen rates, (iv) interpolate term SOFR if there is a missing middle maturity and (v) make the decisions in step 6 of the Replacement Benchmark waterfall and step 3 of the Replacement Benchmark Spread waterfall?

R.: We, as issuer, would be willing to perform the steps/calculations above mentioned.

Question 12: Is there any provision in the proposal that would significantly impede FRN issuances? If so, please provide a specific and detailed explanation.

R.: At this stage, we don't foresee any impact on our FRN issuances apart from the lack of liquidity on Libor-linked issuances in the period prior to the Libor cessation.

Question 13: Please provide any additional feedback on any aspect of the proposal.

R.: We believe it should be an effort to align as much as possible cash products standard fallbacks with the ones recommended for derivatives under the ISDA definitions. We understand that the standardization between the two types of products is important to avoid any possibilities of arbitrage or basis risk to market participants.