

## ARRC Consultation on Securitizations

### Section A: General Approach of the Securitization Fallback Provisions

**Question 1.** Which securitization asset classes are you referring to in your response to this consultation if limited to only certain asset classes? If there are particular features of these asset classes that shape your responses to the questions in this survey, please describe them to the extent possible.

Answer:

- Credit cards, commercial mortgages, collateralized loan obligations (CLOs) and other asset classes that reference LIBOR.

### Section B: Triggers

**Question 2.** The ISDA triggers contemplate a permanent cessation of LIBOR as of a date certain which may be announced in advance (the “Cessation Date”), at which point the transition from LIBOR to SOFR would occur. As there may be operational challenges for securitizations as both assets and liabilities will have to be transitioned, some have asked for the ability to transition in advance of the Cessation Date in order to address any operational issues that may arise. Specifically, the Designated Transaction Representative (as defined in Appendix I) will have the ability to pick one date within a 30-day period prior to the Cessation Date to facilitate an orderly transition. Do you feel the inclusion of this ability to transfer prior to the Cessation Date is needed? If so, please explain the specific, critical and tangible needs that support its inclusion?

Answer:

- We are supportive of an issuer having the ability to transition earlier if it facilitates an orderly transition. There may be an operational benefit to this. However, it should be clearly specified in the transaction documents how this discretion is used by the Designated Transaction Representative or there could be a risk of legal liability and litigation.

**Question 3(a).** Should fallback language for Securitizations include any of the pre-cessation triggers (clauses (3), (4), (5) and (6) of the Benchmark Discontinuance Event definition)? If so, which ones? Also, please identify any pre-cessation triggers that you do not believe should be utilized for a particular securitization product and explain why.

Answer:

- We support triggers 4, 5, and 6 in cases where there is no derivative hedge associated with the securitization. Where there is a derivative hedge, alignment of the fallback provisions is necessary between the securitization and the derivative. Our concerns on alignment are further outlined in our response to Question 3(b).
- We have concerns that trigger 3 may be arbitrary and may not represent a permanent discontinuation of a benchmark. We can contemplate a situation where a benchmark is not

available for 5 days (due to operational disruptions), but could resume publication on the 6th day. Further disputes are likely to arise as to the definition of 5 days (e.g. from what time does the 5 day count start, etc.). Moreover, if there is a continuous disruption to a benchmark to the point where it may represent a permanent discontinuation, trigger 5 would likely occur in that event.

- However, it should be noted that the scenario in trigger 3 is highly unlikely. Given the dependency of the market on LIBOR, the regulator and administrator would likely make an announcement or provide guidance on why LIBOR is not available, even if the disruption is only for one day. We would expect regulatory intervention to swiftly follow such a disruption.

**Question 3(b).** *Please indicate whether any concerns you have about these pre-cessation triggers relate to the differences between these securitization triggers and those for standard derivatives or whether your concerns relate specifically to the pre-cessation triggers themselves.*

Answer:

- From the perspective of securitizations alone, triggers 4, 5 and 6 are suitable. However, our concerns with these pre-cessation triggers are centered on their deviation from the derivatives market.
- We do have concerns with trigger 3 as noted in our response to Question 3(a).
- For some securitizations (depending on their structure), alignment with the derivative is absolutely necessary. These securitizations have a segregated pool of assets and their own credit rating and depend on the derivative to ensure it can meet its payment commitments. Unlike other cash products (e.g. floating rate notes (FRNs)), the sponsor or servicer cannot merely step in and cover any deficiencies (there could be negative consequences for doing so). If there is misalignment between the securitization and its hedge, they can fallback to different rates, creating basis risk. The rating agencies may downgrade the rating of the securitization as a result.
- Another concern is whether derivatives that include the additional pre-cessation triggers could be cleared. Issuers who seek alignment between the securitization and the derivatives could include the pre-cessation triggers in the derivatives documentation. However, in order to clear those derivatives, those pre-cessation triggers must meet the requirements outlined by the central counterparty.

**Question 3(c).** *If you believe that the pre-cessation trigger in clause (6) (Asset Replacement Percentage) should not be retained, please note any specific concerns leading to this conclusion. If you believe that it should be retained, are there any changes you believe should be made to this trigger? Please explain.*

Answer:

- If the underlying asset to the securitization is tied to LIBOR, we would want both the underlying asset and the liability of the securitization to move to the replacement rate together (base rate change).

**Question 3(d).** *If you believe the pre-cessation trigger in clause (6) (Asset Replacement Percentage) should be retained, how would you address concerns that it could result in a transfer of value in a transaction where the Designated Transaction Representative has the ability to change the benchmark used on the underlying assets and, as a result, determine the timing of this pre-cessation trigger? Are there other changes that should be made to the Asset Replacement Percentage trigger? Note that this trigger relates to a mismatch between the securities and the Securitization assets that results from changes in the assets. A mismatch may also arise from a change in the securities due to a trigger event under these fallback provisions. Any concerns with the latter scenario can be addressed in responses to Question 16.*

Answer:

- No comment.

**Question 3(e).** *If pre-cessation triggers are not included, are there options available to market participants to manage the potential risks involved in continuing to reference a Benchmark in the circumstances contemplated by each of these pre-cessation triggers?*

Answer:

- We encourage ISDA to help the market mitigate against such risk.
- We encourage the ARRC to work with ISDA to determine whether the pre-cessation triggers could be included as possible fallback triggers for derivatives contracts (either a mandatory or opt-in trigger).
- We also encourage the ARRC to work with the major central counterparties (CCPs) to ensure that derivatives which include the pre-cessation triggers can be cleared.

#### Section C: Benchmark Replacement Date

**Question 4.** *Should the proposed securitization fallback language permit the Designated Transaction Representative to transition the securities after a trigger has occurred but before the Benchmark Replacement Date? Should any limitations be placed on its use? Should there be a limited date range (e.g., 60 days) prior to the Benchmark Replacement Date in which this could be used? Should the Designated Transaction Representative be limited in the circumstances under which it could elect to utilize the additional time? If so, what standard should be utilized to assess whether the additional time is necessary? In each case, please explain why.*

Answer:

- See our response to Question 2.

#### Section D: Replacement Benchmark

**Question 5(a).** *If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for the securities referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR? Please explain why.*

Answer:

- Yes, the ARRC recommended forward-looking term rate should be the primary fallback for securitizations referencing LIBOR. Ideally, all product classes would move towards this forward-looking term rate, whether it is term SOFR or another market-agreed benchmark rate. It is particularly important for securitizations to have a forward-looking term rate for SOFR.
- However, as noted in our responses to Questions 3(a) and 3(b), for securitizations with a swap, we would prioritize alignment over having a forward-looking term rate for the securitization.
- Sophisticated firms (such as banks and other large financial institutions) may be able to manage their exposures to term SOFR and compounded SOFR separately. These firms may have to put capital against, and incur basis risk for, any mismatch between their securitization and the related hedges; whereas corporations may have more flexibility. However, a bifurcation in the market between those that use swaps and those which do not is likely not to be sustainable or desirable. It is very likely that the methodologies would ultimately align with the derivatives market.

**Question 5(b).** *Is there a specific reason that the securitization market should first fall back to forward-looking term SOFR instead of another rate? Please explain why.*

Answer:

- In line with current market practice, investors and issuers want to know the term rate and payments for a given tenor at the beginning of the period and not at the end.
- Special purpose vehicles (SPVs) using securitizations will want to have predictable cash flows to meet obligations. SPV's access to liquidity is limited to the underlying assets and related hedges.

**Question 5(c).** *Is the use of an Interpolated Period appropriate in the securitization markets? Please explain any limitations that should be applied to the use of an Interpolated Period.*

Answer:

- In the transition period shortly after the market moves to a forward-looking term SOFR, interpolation may be appropriate when certain tenors are not available.
- There are situations where a securitization should not be transitioned to a successor at the point of transition. Take, for example, a securitization referencing 3-month LIBOR that is halfway through the 3-month tenor period when the trigger is activated. That securitization should not move to the successor rate at that time. Instead it should continue to reference the 3-month LIBOR rate until the end of the tenor, at which point it will transition to the successor rate. This would decrease the need for interpolation.

**Question 5(d).** *In the event a Replacement Benchmark is determined other than under Step 1 of the waterfall, should the waterfall provide that the Replacement Benchmark be changed in the future as soon as a rate can be established under Step 1 of the waterfall?*

Answer:

- Conceptually, we support a forward-looking term SOFR as the rate. However, there are significant operational issues with retesting.
- As noted in our response to Question 10(b), retesting and determining a different successor rate would lead to adjusting the derivatives hedge potentially multiple times to ensure alignment. For securitizations with derivatives, alignment is a priority. If the securitization and derivative fallback on the same rate during the initial transaction, there is a risk retesting could cause a misalignment, which is undesirable.

**Question 6(a).** *Should Compounded SOFR be the second step in the waterfall? Would this preference be influenced by whether ISDA implements fallbacks referencing Compounded SOFR or overnight SOFR?*

Answer:

- Yes, compounded SOFR should be included as the second step in the waterfall. This is in line with the results of the ISDA consultation on derivatives fallbacks.
- It should be noted that SOFR and SONIA FRNs who use compounding in arrears methodology to determine the rate do so with a 2-5 day lag; such a lag would be appropriate for securitizations as well.
- Some RFR derivatives use a compounding in arrears methodology without a lag period; such would be hard to implement for securitizations and introduce operational risk.

**Question 6(b).** *If you believe that Compounded SOFR should be included, which compounding period is preferable (“in arrears” or “in advance”)? Please explain why. Would this preference be influenced by whether ISDA implements fallbacks referencing Compounded SOFR “in arrears” or “in advance?” Please explain whether your preference is based on operational concerns in implementing a particular approach or on economic concerns.*

Answer:

- Yes, we prefer compounding in arrears methodology as it is in line with the results of the ISDA consultation on derivatives fallbacks.
- As noted in our response to Question 6(a), FRNs who use compounding in arrears to determine term SOFR and SONIA typically do so with a 2-5 day lag and such a lag would be appropriate for securitizations as well.

**Question 6(c).** *If it was necessary to calculate Compounded SOFR and a third party was not available to perform those calculations, are there parties to the Securitization transactions with sufficient resources to perform those calculations accurately and efficiently? Are there other considerations relating to the calculation of Compound SOFR that would make it an undesirable Replacement Benchmark without the availability of a third party provider?*

Answer:

- The preference would be for a third party to calculate compounded SOFR. However, if such a third party was not available, trustees, calculation agents, the servicer, the sponsor or even an affiliate of the issuer could perform the calculations if needed.
- Certain firms may not have the infrastructure in place to calculate and use compounded SOFR; it would be costly and uneconomical for them to update their systems in order to do.

**Question 7.** *As noted, this consultation does not include Spot SOFR as a third step in the waterfall. Do you believe that Spot SOFR is an appropriate fallback reference rate for Securitization contracts or should the second step in the replacement rate waterfall be Compounded SOFR, after which the replacement rate would be, first, recommended by the Relevant Governmental Body, second, default to then-current ISDA Definitions, and third, proposed by the Designated Transaction Representative?*

Answer:

- Overnight spot SOFR is not an appropriate fallback reference rate for securitizations and should not be included in the waterfall. If spot SOFR is available, a compounded SOFR could be derived from that rate.
- Spot SOFR was widely rejected in the ISDA consultation on fallback provisions for derivatives products.
- Spot SOFR has high daily volatility, with spikes around month and quarter ends. To illustrate, SOFR ranged greatly from the end of 2018 to the beginning of 2019:
  - o December 28, 2018 – 2.46%
  - o January 2, 2019 – 3.15%
  - o January 4, 2019 – 2.45%
  - o January 30, 2019 – 2.39%
  - o January 31, 2019 – 2.58%
  - o February 1, 2019 – 2.47%

**Question 8.** *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? Please explain why.*

Answer:

- Yes, the Relevant Governmental Body would have the clout to recommend a replacement benchmark rate that would be adopted by the broader market.

**Question 9.** *In the future circumstance where there is no SOFR-based fallback rate and the Relevant Governmental Body has not recommended a replacement rate for Securitizations, is the fallback for SOFR-linked derivatives set forth in the ISDA definitions at the time of cessation the best alternative at this level of the waterfall? Is this fallback appropriate if ISDA Definitions only include overnight fallback rates? Please explain why.*

Answer:

- The ISDA definitions could change over time with developing market conventions. Incorporating the ISDA definitions by reference would allow the securitization to evolve in line with market practice without amending the documentation. Thus, it would be the best alternative at this level of the waterfall.
- When implementing the ISDA fallback rate, securitization-specific operational requirements must be considered. For example, as noted in our responses to Questions 6(a) and 6(b), if a compounding setting in arrears methodology is used, a “lag” period of 3-5 days is necessary for securitizations.

**Question 10(a).** *Since it is unlikely that there will be no ISDA fallback (clause (a) above), this provision is more likely to occur (if at all) when the ISDA fallback is deemed not appropriate for securitization securities (clause (b) above). In that scenario, is this provision appropriate as the final step in the Replacement Benchmark waterfall? Please explain why.*

Answer:

- The priority is to ensure that there is a fallback. A rate determined by the Designated Transaction Representative is appropriate as the final step in the waterfall. Ideally, the Designated Transaction Representative would be an independent third party, but it would be difficult to find an entity who would take on the role given the potential liabilities.
- Alternatively, the calculation agent could also determine the fallback rate and ideally they would be an independent third party as well.

**Question 10(b).** *Should the provision allow for “re-testing” the waterfall to determine whether another Replacement Benchmark has become available in the scenario where investors have rejected the Proposed Replacement Benchmark? Should the waterfall be re-tested in any other circumstances (e.g., any time the Replacement Benchmark has been determined under a “less-desirable” clause)? How often? Please explain why.*

Answer:

- We understand that trustees are strongly opposed to retesting and going through the waterfall after a rate has been set from step 2 or further down the waterfall.
- From an issuer perspective, retesting and determining a different successor rate could lead to a need to adjust the derivatives hedge potentially multiple times to ensure alignment. For securitizations with derivatives, alignment is a priority. If the securitization and derivative fallback on the same rate during the initial transaction, there is a risk retesting could cause a misalignment, which is undesirable. Issuers could also have concerns about the investor “veto” over the replacement benchmark.
- It should be noted that ISDA is not contemplating a retesting mechanism.
- As market consensus evolves, we will follow the market convention. This is a onetime determination unless there is a discontinuation of the successor rate.
- There is also the question of who will be doing the retesting and administrative work. It would likely fall on the issuers or trustees (the latter of which have strongly opposed retesting). While

there is value to retesting, it introduces additional administrative tasks and liability for the party responsible for retesting.

- We support alignment with the FRN market on this matter.

#### Section E: Replacement Benchmark Spread

**Question 11.** *Are there any concerns if a spread adjustment was utilized with cash products that was calculated by a spot rate comparison of the difference between LIBOR and the Replacement Base Rate at the time of conversion? Should this option be included in the spread waterfall? If so, where?*

Answer:

- We agree with the results of the ISDA derivatives fallback consultation, where this methodology was widely rejected. A spot spread adjustment should not be incorporated into the spread waterfall for securitizations.

**Question 12.** *Do you believe that the ARRC should consider recommending a spread adjustment that could apply to cash products, including Securitizations?*

Answer:

- Yes, the ARRC should consider recommending a spread adjustment for cash products. The regulators have the authority and clout to recommend a spread adjustment that could be adopted broadly in the market taking into consideration the changes to the underlying as well. This would be particularly needed if there is a material impact resulting from the transition to a new replacement reference rate.
- For securitizations, the ARRC should look to the spread applicable for the underlying to reduce the basis risk. The spread applicable to the securitization should be comparable to spread applied to the underlying.
- The fallbacks to securitizations should have alignment with FRNs more broadly.
- Alternatively, the ARRC could recommend a methodology for the spread adjustment which allows for a more dynamic spread.
- While some vendors are trying to occupy this space, it is unclear if they would have the authority or influence to recommend a spread adjustment that would be widely accepted.
- If spread adjustments are recommended by the ARRC, the term and credit spreads should be separately quoted.
- The ARRC should give thought to aligning the fallback rates and spread adjustments for securitizations and their underlying assets, thereby reducing basis risk.

**Question 13(a).** *Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the spread waterfall? Please explain why.*

Answer:



- Yes. Issuers want alignment with the derivatives market, and some may even want to use the ISDA spread as the first priority as it would reduce basis risk.
- If a compounding methodology is used to determine a term rate, the credit spread should be applied after compounding. Convexity issues would arise if the credit spread was first applied and then the rate was compounded.
- However, the spread adjustment determined needs to be compatible with the fallback rate. As noted in the ISDA consultation, there are term structure and credit spread methodologies which are not compatible. See the table below taken from page 16 of the ISDA consultation for more details.

	Forward Approach	Historical Mean/Median Approach	Spot-Spread Approach
Spot Overnight Rate	Not compatible		
Convexity-adjusted Overnight Rate	Not compatible		
Compounded Setting in Arrears Rate			Not compatible
Compounded Setting in Advance Rate			

**Question 13(b).** *If the ARRC has recommended a forward-looking term SOFR but has not recommended a corresponding spread adjustment under Step 1 above, do you believe that the ISDA spread adjustment described in Step 2 (which may be intended to apply to a different Replacement Base Rate) should apply to Securitizations? Please explain why.*

Answer:

- We would need the spreads quoted separately. In the securitizations space, typically 1- or 3-month LIBOR is used. We would have to get the spread differential between 1- or 3- month LIBOR and term SOFR.
- We are comfortable using a term SOFR to determine the spread.
- As noted in our response to Question 13(a), the spread adjustment applied needs to be compatible with the fallback rate. There are term structure and credit spread methodologies which are not compatible.

**Question 13(c).** *Given that ISDA has not yet decided upon the spread calculation methodology, should Step 2 be excluded from the waterfall? Please explain why.*

Answer:

- Step 2 should not be excluded from the spread waterfall. ISDA has settled on the principles of the spread methodology, the historical mean/median approach, but the details have yet to be finalized (e.g. lookback period, using a mean or median, etc.).
- To the extent that an issuer wishes to be an early adopter of the ISDA methodology, the fallback language for the securitization would need to specify that they are using historical mean/median approach.

Section F: Responsibility for Calculations

**Question 14(a).** *What type of institution can and should take on the responsibility 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/or (v) elect to cause an early transition under the proviso to the definition of Benchmark Replacement Date?*

Answer:

- For (i), the supervisor, industry association or calculation agent can make the determination that a trigger has occurred. Our preference would be for the supervisor, followed by the industry association, to make the determination. The supervisor and industry association would have the clout to make such a determination and avoid potential disputes and litigation. This would be most relevant for the pre-cessation triggers, but it can also help resolve any ambiguity as to whether triggers 1 or 2 occurred.
- Calculation agents, trustees or servicers for the deal could take on the role for (ii)-(v). For these tasks a party that is “closer” to the transaction would be preferable.
- There is potential liability for such institutions to take on the responsibilities outlined in (i)-(v); thus institutions may be reluctant to assume these roles. Regulators should provide regulatory cover to such entities to encourage them to provide these necessary services.

**Question 14(b).** *Whether as issuer, sponsor, servicer or 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/or (v) elect to cause an early transition under the proviso to the definition of Benchmark Replacement Date?*

Answer:

- Whether we, as issuer, sponsor, servicer or calculation agent, are willing to provide the services outlined above would depend on the circumstances.

Section G: General Feedback

**Question 15.** *Is there any provision in the proposal that would significantly impede Securitization issuances? If so, please provide a specific and detailed explanation.*

Answer:

- Other than the items above which we recommended against, there is nothing else in the proposal which could significantly impede issuances.
- The ARRC should give thought to aligning the fallback rates and spread adjustments for securitizations and their underlying assets, thereby reducing basis risk.

- There should be broader alignment between securitizations and FRNs, as well as the other cash products (e.g. loans). This alignment would help the market transition.

**Question 16.** *Given the fallback language for the Securitization and the underlying assets may operate independently, please identify any sources of misalignment between those components that are not addressed in the consultation.*

Answer:

- There could be differences in the successor rate and spread adjustments applied to the securitization product and the underlying assets, thereby creating basis risk.
- The ARRC should opine on the rate/spread applied to the securitization and how it would interact with the rate/spread that applies to the underlying.

**Question 17.** Are there specific operational challenges that implementing the proposed fallback language might create for securitizations? If so, what are those challenges and under what circumstances might they occur? How might they be mitigated?

Answer:

- The differences between securitizations and other cash products include: how the underlying assets interact with the securitizations, the securitization asset pool operating independently from the issuer, etc.
- The transition from LIBOR to SOFR or another market-agreed rate will pose significant operational challenges on market participants. These issues include: product valuation and risk management, updating internal systems/models, cross-currency market (the characteristics of the alternative rates differ between jurisdictions), harmonization of the transition across products/jurisdictions, and tax/accounting.
- As noted in the response to Question 14(a), institutions may be wary of the liabilities that may arise from assuming the roles outlined in (i)-(v). Regulators should provide regulatory cover to such entities to encourage them to provide these necessary services.

**Question 18.** Please provide any additional feedback on any aspect of the proposal.

Answer:

- Ideally, the fallback would be a forward-looking term rate if one develops to be consistent with cash products currently. We have concerns regarding the development of a term SOFR rate, which under the current ARRC paced transition plan is set for the end of 2021. This will not give the market sufficient time to transition over before the discontinuation of LIBOR, which is also expected at the end of 2021.
- A key goal is also alignment between the securitization and the associated derivative hedge. For some securitizations with a derivative hedge, alignment is top priority.
- Firms wish to avoid mismatches between the rates at which they access funding and the rates which are charged to clients.

- The approach for the securitizations market should be aligned with that for FRNs and cash markets more broadly.
- The ARRC should give thought to aligning the fallback rates and spread adjustments for securitizations and their underlying assets, thereby reducing basis risk.