ARRC
Alternative Reference Rates Committee | Newsletter

August – September 2020

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 transition in the U.S. and global markets.

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Top 3 Takeaways

1. **The ARRC released two Requests for Proposals (RFP).**
    - The ARRC released an RFP seeking a potential administrator to publish forward-looking Secured Overnight Financing Rate (SOFR) term rates. This follows the publication of the ARRC's 2020 Objectives, which aimed to establish an RFP process to select an administrator to produce recommended forward-looking term SOFR rates, to be published in the first half 2021 if liquidity in SOFR derivatives markets has developed sufficiently. Responses to the RFP will be used by the ARRC to identify an administrator who could be responsible for the calculation and publication of forward-looking SOFR term rates. This does not guarantee that any SOFR term rate or administrator will ultimately be recommended by the ARRC. Responses to the RFP are due by October 31, 2020.
    - The ARRC also released an RFP seeking firm(s) to publish daily indicative spreads and, after a trigger event has occurred, static spreads and spread-adjusted SOFR fallback rates for cash products that transition away from U.S. dollar (USD) LIBOR. The ARRC will use responses to the RFP to identify administrators(s) who will be responsible for calculating and publishing the spreads and the resulting interest rates based on the ARRC's recommended fallback adjustment methodology. Responses to the RFP are due by October 16, 2020.

2. **The Chair of the ARRC, Tom Wipf, sent a letter urging ARRC members to be prepared to sign onto the International Swaps and Derivatives Association's (ISDA) IBOR Fallbacks Protocol. Adherents to the Protocol will agree existing transactions entered into with other adherents will incorporate ISDA's new fallbacks.**
    - To aid preparation, the ARRC updated its Best Practices to include adherence to the ISDA Protocol among its priority recommendations related to derivatives. While the Best Practices have always recommended adoption of the Protocol, the updates: encourage firms with significant derivatives exposures to adhere during the escrow period; clarify the timing; and recommend that all market participants adhere within the 3-4 month period after publication and it takes effect.
    - ISDA CEO Scott O'Malia posted informal comments and sent a letter to the Official Sector Steering Group Co-Chairs Andrew Bailey and John Williams on ISDA's proposed timing Protocol and Supplement.
        - Since ISDA is still waiting to receive a positive Business Review Letter from the U.S. Department of Justice, ISDA proposed an approximately two-week "escrow" period and an approximately three-month open period between publication and going into effect. This is largely consistent with earlier proposals but is now more likely to imply an effective date in January 2021.

3. **The Commodity Futures Trading Commission (CFTC) modified and issued no-action letters on August 31 to provide additional relief to market participants transitioning from LIBOR.**
    - This relief was issued in response to the ARRC's issues list from July 20 and swaptions letter from June 16 requesting modifications to the existing IBOR no-action relief previously granted in CFTC Letters 19-26, 19-27, and 19-28. While the ARRC believed the CFTC's earlier no-action letters addressed many of the regulatory issues in the transition, the ARRC requested certain modifications in its issues list and letter to further ensure a smooth and orderly transition away from LIBOR and other IBORs.

Other ARRC Developments

- The ARRC hosted the SOFR Summer Series which included six panel discussions and presentations from representatives across various ARRC member institutions. The six sessions can be viewed at the links below:
    - July 13: Libor: Entering the Endgame
    - July 15: SOFR Explained
    - July 22: Preparing to Move from LIBOR Derivatives
    - July 29: Accounting/Tax/Regulation
    - August 3: Approaching the Transition
    - August 7: Office Hours Live
- The ARRC released the SOFR Starter Kit, a set of factsheets to inform the public about the transition away from USD LIBOR to SOFR, including the history and core issues involved in transitioning. It is segmented into three parts:
    - Part I: History and Background
    - Part II: Key Facts about SOFR
    - Part III: SOFR Next Steps
- The Consumer Products Working Group of the ARRC developed the LIBOR ARM Transition Resource Guide to assist in the transition of residential LIBOR-based Adjustable Rate Mortgages, including home equity products, to a new index upon the cessation of LIBOR. The Consumer Products Working Group also created the Legacy LIBOR-Based Private Student Loan Transition Resource Guide to assist impacted stakeholders as they prepare to transition their LIBOR-based variable rate private student loan portfolio that will exist after 2021 to a new index.
- The ARRC updated recommended contractual fallback language for new originations of USD LIBOR-denominated bilateral business loans. The original recommendations were released in May 2019. The updated bilateral business loan fallback language adjusts the "Hardwired Approach" to recommend the use of Daily Simple SOFR in the second step of the waterfall and updates the "Hedged Loan Approach" to include a benchmark rate floor.
- The ARRC also released its technical reference document intended to support the previously released syndicated loans conventions to include a discussion, and accompany spreadsheets, of the different lookback and other potential methodologies that the ARRC had considered.
- The ARRC released an addendum to its recommendations that a voluntary exchange of cash compensation take place between counterparties to legacy swaptions referencing USD LIBOR and that counterparties specify an agreed discount rate using SOFR for new swaptions expiring after October 16, 2020.
    - The addendum was added to avoid an extended period of uncertainty and preempt potential disputes, stating that, if counterparties cannot reach an agreement on the exchange of compensation before October 16, 2020, "then the counterparties should amend their legacy swaptions to bring them into scope for ISDA's Supplement 64 and specify an Agreed Discount Rate consistent with the swaptions' existing contractual terms."

U.S. Developments

- New York Fed Executive Vice President and General Counsel Michael Held delivered remarks at the IMN Virtual Investors' Conference on LIBOR that encouraged "decisive action" to prepare for the transition. Among other points, he described the ARRC's proposed legislation for contracts, highlighted the important role of ISDA's forthcoming IBOR Fallbacks Protocol, and described the official sector's role in supporting the transition.

- New York Fed Senior Vice President Nathaniel Wuerffel delivered remarks at the Bank Policy Institute's Credit-Sensitive Benchmark symposium. He reinforced the need for the world to move on from LIBOR to a more robust alternative reference rate; reminded the audience why the ARRC chose SOFR as its preferred alternative rate; and discussed transition challenges for commercial loan products.
- The Financial Industry Regulatory Authority issued a regulatory notice outlining steps and sharing practices for firms to implement to prepare for the transition from LIBOR. The notice included a summary of results of a survey from a representative cross-section of member firms, including some firms with significant LIBOR-linked securities trading volume or positions.
- The Securities Industry and Financial Markets Association (SIFMA) hosted a webinar on September 16 to discuss how operations professionals need to prepare for the transition to alternative reference rates. This SIFMA Webinar is part of a series on operations titled "What Operations Professionals Need to Know".
- Ginnie Mae announced restrictions on the pooling of LIBOR-based Adjustable Rate Mortgages. Details of the restrictions, which are effective with security issuances dated on or after January 21, 2021, are published in Ginnie Mae's All Participant Memorandum 20-12. This guidance follows Ginnie Mae's adoption of the ARRC's recommendations relating to fallback language for new issuances of LIBOR floating rate securities.
- The Federal Farm Credit Banks Funding Corporation announced the offer to exchange its existing LIBOR-indexed bonds for corresponding new LIBOR-index bonds. The new bonds will be substantially the same terms except they will include fallback language based on the ARRC's recommended fallback language for floating rate notes.
- GlaxoSmithKline refinanced two core revolving credit facilities to be linked from the commencement date to both the SONIA and SOFR compounded in arrears. This step was taken "to align with the latest UK and US regulatory and industry working group recommendations while achieving consistency across currencies and geographies."

Market Developments

- ISDA hosted a virtual conference on September 16 to explore the progress made in Hong Kong, Singapore, Australia and other Asian markets to shift away from LIBOR and adopt alternative reference rates. The event also set out the issues Asian market participants need to consider when transitioning legacy portfolios and outlined upcoming transition milestones.
- The International Accounting Standards Board issued the Interest Rate Benchmark Reform—Phase 2, which amends IFRS 9 Financial Instruments, IAS 39 Financial Instruments: Recognition and Measurement, IFRS 7 Financial Instruments: Disclosures, IFRS 4 Insurance Contracts and IFRS 16 Leases. The amendments provide investors with information about the effects of the reform of inter-bank offered rates and other interest rate benchmarks on companies' financial statements, including information regarding changes to contractual cash flows, hedge accounting and disclosures.

International Developments

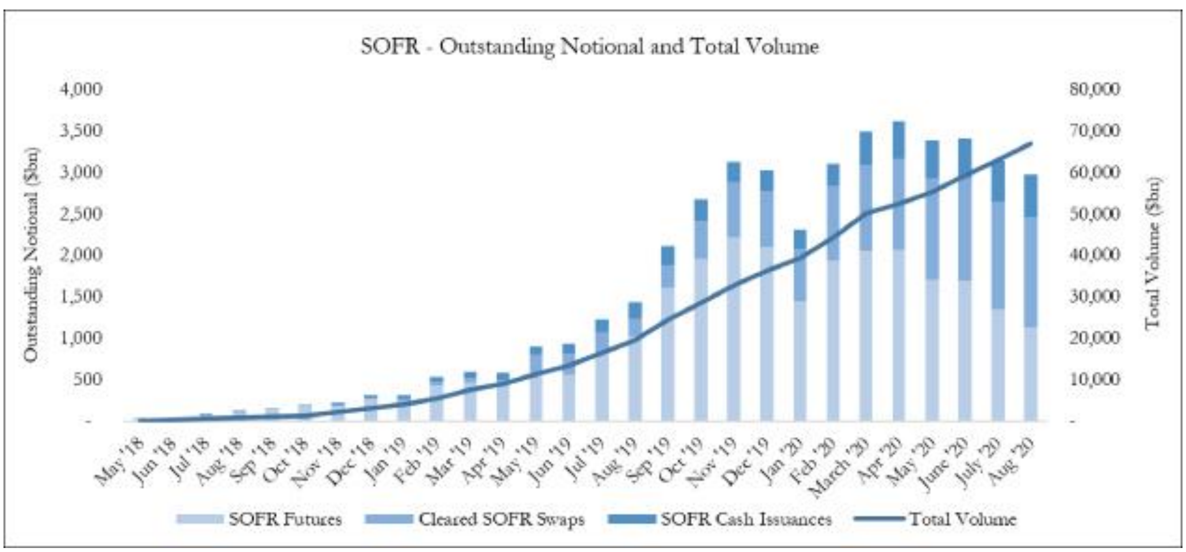
For more details on international efforts for reference rate reform, see the working groups in the U.K., Switzerland, Japan, Hong Kong the euro area, and the Official Sector Steering Group.

- Edwin Schooling Latter, Director Markets and Wholesale Policy at the Financial Conduct Authority, delivered remarks during an ISDA webinar, "The Latest in LIBOR Transition, The Path Forward". The speech highlights the importance of the next four to six months in the transition away from LIBOR and of adhering to the upcoming ISDA Fallbacks Protocol.
- The Bank of England updated the Form ER (effective interest rates) definitions and the form template for the small or medium sized enterprise floating rate loan series to reference SONIA, rather than LIBOR/SONIA. The update to ER definitions is being made now to facilitate a smooth transition from LIBOR to SONIA.

- The Working Group on Sterling Risk-Free Reference Rates released a recommendation on conventions for referencing compounded in arrears SONIA in the sterling loan market to support the target for lenders to be able to offer non-LIBOR alternatives to customers by October 1. The recommendation is based on a survey of market participants and discussions with loan infrastructure providers and other working groups. In summary,
    - SONIA compounded in arrears remains the recommended alternative
    - Use of a Five Banking Days Lookback without Observation Shift is recommended as the standard approach
    - When interest rate floor is used, it may be necessary to apply the floor to each daily interest rate before compounding
    - Accrued interest should be paid at the time of principal prepayment
- The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks released a second consultation on the appropriate choice and usage of Japanese Yen interest rate benchmarks which considers developments since the publication of the final report on the results of the last public consultation published in November 2019. The consultation asks for public comments on fallbacks in cash products as well as improving the robustness of term reference rates. The comment period for the consultation ends on September 30.
- The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks also updated its terms of reference and updated its list of participants which includes members and observers.
- The Hong Kong Monetary Authority (HKMA) was re-appointed as the chair of the Working Group on Financial Markets of the Executives' Meeting of East Asia-Pacific Central Banks for a two-year term from 2020 to 2022. In its previous term, the HKMA facilitated a study on the implications of financial benchmark reforms with a view to enhancing market readiness for removing the remaining dependencies on LIBOR by the end of 2021. In the upcoming term, the HKMA will continue to foster discussions and studies on issues concerning financial markets in the region.

SOFR Market Liquidity

- Since SOFR's publication, approximately $760bn notional in floating rate instruments tied to SOFR have been issued, with over $511bn outstanding notional at August month-end.



(As of August 31, 2020; Source: CME Group, LCH, ICE)

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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