ARRC
Alternative Reference Rates Committee | Newsletter

December 2019 - January 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.

ARRC Developments

- The ARRC released a consultation on spread adjustment methodologies for cash products referencing U.S. dollar (USD) LIBOR. It proposes a static spread adjustment that would be implemented at a specific time on or before USD LIBOR's cessation and would make the spread-adjusted version of the Secured Overnight Financing Rate (SOFR) comparable to USD LIBOR.
- The ARRC also released final recommendations for new interdealer cross-currency basis swaps that use SOFR and overnight risk-free rates (RFRs) recommended by National Working Groups in other jurisdictions.
- The ARRC also released a vendor survey and a buy-side checklist. Both documents are intended to support market participants' work to address operational challenges in the transition. As noted in the letter sent with the survey, the survey serves as a self-assessment tool for software and technology vendors to assess their own readiness, while also serving as a platform to raise operational issues to the ARRC. The deadline to respond to the survey is March 16, 2020.
- ARRC Chair Tom Wipf authored a Bloomberg opinion-editorial on the transition to SOFR. The op-ed addresses SOFR in the context of year-end money market pressure, and highlights the New York Fed's consultation on the publication of SOFR averages and a SOFR index. Tom also authored a Wall Street Journal letter-to-the-editor highlighting the ARRC's choice of SOFR as the strongest replacement for USD LIBOR, noting that, unlike LIBOR, "[SOFR] is robust, reliable through economic cycles and better reflects the way financial institutions fund themselves."
- The ARRC's Accounting and Tax Working Group released a letter to the Securities and Exchange Commission (SEC) that describes the ARRC's understanding of SEC feedback about the ARRC's Proposal for Relief on Preferred Shares. The letter sets out the ARRC's understanding that, if certain conditions are met, SEC staff will not object to the conclusions that certain amendments to preferred shares related to the transition away from LIBOR would be accounted for as a modification, rather than an extinguishment, and that such a modification will not result in the recognition of an exchange of value.
- The ARRC released a comment letter to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Reserve Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency (together, the "Agencies") in response to their proposal to change the swap margin rules to facilitate the implementation of prudent risk management strategies at certain banks and swap entities. The ARRC's response focuses on the provisions of the proposed rule to facilitate a smooth transition away from LIBOR and other Interbank Offered Rates (IBORs).
- The ARRC's Tax Subgroup released a letter requesting the U.S. Treasury Department and the Internal Revenue Service's (IRS) guidance relating to the forthcoming International Swaps and Derivatives Association (ISDA) Protocol regarding the incorporation of robust IBOR fallback provisions. The letter requests clarity on whether adherence to the ISDA Protocol or adoption of comparable fallback provisions will qualify for the relief provided in the proposed regulations issued by the Treasury and IRS in October.

U.S. Developments

- In response to ARRC requests, the U.S. Commodity Futures Trading Commission staff provided relief to market participants relating to the transition from swaps referencing IBORs. The relief covers requirements applicable to swap dealers, the trade execution requirement and mandatory clearing.
- The Agencies reopened the comment period on a proposal to change swap margin rules to facilitate the implementation of prudent risk management strategies at certain banks and swap entities through January 23, 2020 to allow additional time for commenters to analyze the proposed rulemaking.
- The New York State Department of Financial Services (DFS) sent a letter directing New York-regulated depository and non-depository institutions, insurers, and pension funds to submit their plans for managing the risks relating to the discontinuation of LIBOR by February 7, 2020. Per DFS Superintendent Linda Lacewell, "Our financial institutions with LIBOR exposure need to prepare to manage the significant risks associated with its likely cessation, and be ready to transition to alternative reference rates."

Market Developments

- KPMG LLP, National Association of Corporate Treasurers, and the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness released a LIBOR Transition Corporate Survey to gauge end-users' readiness to transition away from LIBOR. Survey results will be anonymized and shared with all survey participants. Responses are requested by February 14, 2020.
- The Credit Roundtable produced a survey to gauge the markets' reception to different conventions for using SOFR, in order to help to identify a market consensus regarding a preferred compounding structure for SOFR floating rate notes. The survey is currently open for responses.
- ISDA published letters from the UK Financial Conduct Authority (FCA) and ICE Benchmark Administration that provide some useful detail on the length of time a non-representative LIBOR would be published. In written comments, ISDA CEO Scott O'Malia noted that the letters, "help set out the direction of travel in the event LIBOR is deemed to be non-representative by the FCA. It certainly appears that the official sector and IBA intend to minimize the length of time a non-representative LIBOR is published. That is an important step."
- ISDA launched a supplemental consultation and held an associated webcast on the spread and term adjustments that would apply to fallbacks for derivatives referencing euro LIBOR, EURIBOR, and other less widely used IBORs. The consultation also covered technical issues related to the spread adjustment methodology which reflects the fact that the IBORs have attributes, such as multiple tenors and bank credit risk premium, that the alternative references rates identified as fallbacks do not.
- ISDA also issued a letter in response to the Agencies' proposal to change swap margin rule to facilitate the implementation of prudent risk management strategies at certain banks and swap entities. ISDA supports the proposal's relief for the non-cleared swap margin requirements for counterparties that amend their swaps referencing IBORs. ISDA also recommends certain conditions to further facilitate a smooth and early transition away from IBORs.
- Additionally, ISDA issued a letter to the Financial Stability Board's Official Sector Steering Group (FSB OSSG) on pre-cessation triggers for derivatives fallbacks. The communication is in response to a November 2019 letter sent by the FSB OSSG, which asked ISDA to include, among other things, a pre-cessation trigger alongside the cessation trigger as standard language in the definitions for new derivatives.
- Freddie Mac brought to market its first multifamily real estate securitization with bonds indexed to SOFR. Freddie Mac's new offering of its Structure Pass-Through Certificates, or K Certificates, include a class of floating rate bonds indexed to SOFR.
- Trading of options on the CME Group's SOFR futures began in early January.
- From late November through December, there were several developments related to cross currency swaps referencing SOFR— with the issuances of the first swap referencing SOFR and the euro short-

term rate (€STR), the first swap referencing SOFR and the sterling overnight interbank average rate (SONIA), and the first swap referencing SOFR and Australia's bank bill swap rate (BBSW).

International Developments

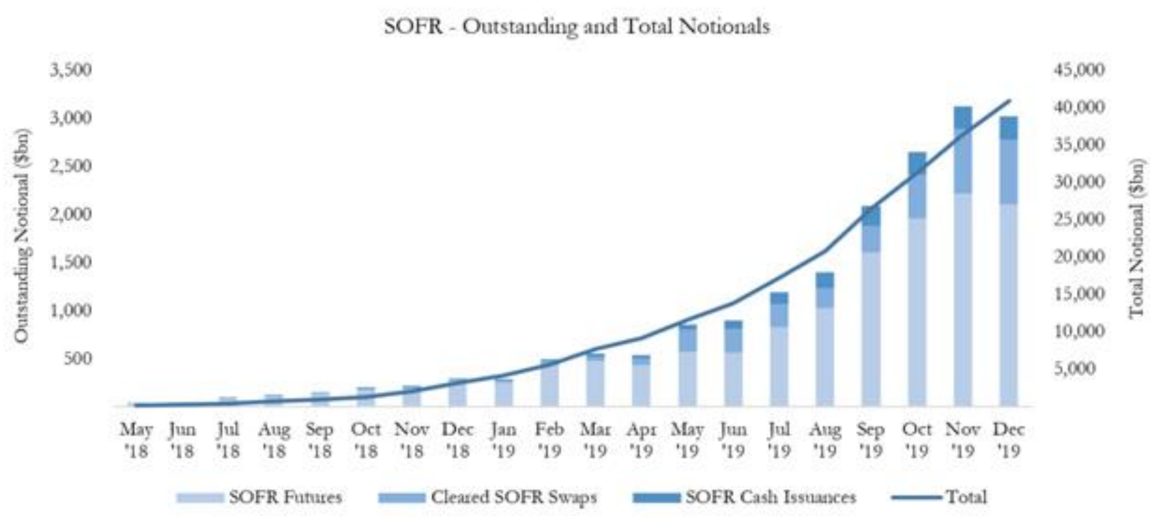
For more details on international efforts for reference rate reform, see the working groups in the U.K., Switzerland, Japan, Hong Kong the euro area, and the Official Sector Steering Group.

- The Bank of England (BoE), FCA, and the Working Group on Sterling Risk-Free Reference Rates published a set of documents, outlining priorities and milestones for 2020 on LIBOR transition. As part of this package, the BoE and FCA published two documents:
    - A joint letter to major banks and insurers supervised in the UK, which outlines their initial expectations of firms' transition progress and highlights the BoE Financial Policy Committee's close monitoring of the steps being taken.
    - A statement encouraging market makers to switch the convention for sterling interest rate swaps from LIBOR to SONIA on March 2, 2020, in order to support transition in the derivatives market.
- The Working Group on Sterling Risk-Free Reference Rates released several updates, including:
    - A consultation on spread adjustment methodologies for fallbacks in cash products referencing British pound sterling (GBP) LIBOR. The consultation considers four methodologies that could be used to calculate the credit adjustment spread and is open for feedback until February 6, 2020.
    - Invitations for membership on three new task forces, focusing on (i) enablers to cease GBP LIBOR issuances by Q3 2020, (ii) frameworks to support transition of legacy cash products and (iii) provision of market input products that may be unable to be converted or amended with robust fallbacks (i.e., "tough legacy").
- The UK Prudential Regulation Authority (PRA) published a response letter to the Working Group on Sterling Risk-Free Reference Rates letter regarding regulatory barriers to transition away from LIBOR. The letter describes the actions the PRA is taking to address the issues raised regarding potential interactions between the prudential framework and benchmark rate reform.
- The National Working Group (NWG) on Swiss Franc Reference Rates released an executive summary of items discussed during its November meeting. Among the items discussed, the NWG agreed to provide further guidance on the options for using compounded SARON. Institutions should define their product strategy given the guidance, and Index providers (e.g., SIX Swiss Exchange) are invited to implement a user friendly and free-to-use calculator for compounded SARON. The NWG will also publish a caps (floors) template and updated SARON swap confirmation.
- The ECB's Working Group on Euro Risk-Free Rates published several updates, including:
    - A December 2019 Newsletter which provides recent working group updates, publications, and information on the launch of the €STR; and,
    - December meeting minutes which focus on upcoming deliverables and planning for H1 2020 and updates from the subgroups working on cash products and derivatives, EURIBOR legal action plan and communications.
- Hong Kong's Treasury Markets Association (TMA) published a consultation conclusion on technical refinements to HKD Overnight Index Average. The publications include the feedback received from the consultation as well as the TMA's responses.
- The Cross-Industry Committee on Japanese Yen (JPY) Interest Rate Benchmarks (the Committee) published several updates, including:
    - The final report on the results of the consultation of Appropriate Choice and Usage of Japanese Yen Interest Rate Benchmarks which asked market participants for feedback on alternative interest rate benchmarks for JPY LIBOR. In general, most respondents supported term reference rates linked to either JPY overnight indexed swaps or overnight call rate futures, highlighting their compatibility with current business operations and systems and trading practices. The Committee will provide support for market-wide initiatives toward the development of term reference rates.

    - The Committee closed its call for entities to calculate and publish prototype term reference rates, noting that it had received applications from a number of entities.
- The Financial Stability Board (FSB) published its annual progress report on implementation of recommendations to reform major interest rate benchmarks. The report calls for increased and ongoing efforts by the official sector and impacted firms to ensure a timely and successful transition away from LIBOR. The FSB announced, as part of its 2020 work program, that it will conduct a survey of LIBOR exposure and supervisory measures being taken to address transition issues.
- At the International Accounting Standards Board's December meeting, the Board discussed hedge accounting issues that could result from reforming interest rate benchmarks. Agenda Paper 14 provides a summary of the Board's tentative decisions to date.

SOFR Market Liquidity

- $314bn notional in floating rate instruments tied to SOFR have been issued, with over $241bn outstanding notional at December month-end.



(As of December 31, 2019; Source: CME Group)

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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