

# ARRC

## Alternative Reference Rates Committee | Newsletter

*February - March 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](#) a consultation on U.S. dollar (USD) LIBOR fallback contract language for new variable rate private student loans, to minimize risks in the event that LIBOR is no longer usable. Feedback should be submitted by May 15.** ARRC Chair Tom Wipf, said: “2021 is fast approaching, and it’s critical that consumers have clarity about how it will impact the financial products they hold. This draft fallback language is an important step in providing consumers with LIBOR-based student loans more certainty about when and how a replacement rate would be selected.”
  - See the consultation [here](#)
2. **The Federal Reserve Bank of New York is now [publishing](#) 30-, 90- and 180-day SOFR Averages and a SOFR Index.** Upon the inaugural publication, Wipf said: “The SOFR Averages and Index equip market participants with consistent, accessible prints that are produced by the official sector. They are also available today for immediate use. Market participants should use them to create new SOFR-based contracts, instead of precariously growing LIBOR exposures and waiting for the development of a forward-looking term SOFR.”
  - Read the full statement [here](#)
3. **The ARRC [released](#) a proposal for New York State legislation to minimize legal uncertainty and adverse economic impacts associated with the LIBOR transition.** The legislation aims to address issues associated with LIBOR-based financial contracts that either do not have adequate fallback language or have language that could dramatically alter the economics of contract terms if LIBOR is discontinued.
  - Read the proposed legislation [here](#)

### Other ARRC Developments

- The ARRC [welcomed](#) the Federal Housing Finance Agency’s announcement that the government sponsored enterprises Fannie Mae and Freddie Mac will no longer accept adjustable-rate mortgages (ARMs) based on LIBOR by year-end. Additional details on the announcement are available in the “U.S. Developments” section below.
- The ARRC [released](#) a [consultation](#) about swaptions based on USD LIBOR that could be affected by central counterparties’ change to the discounting for cleared derivatives from the use of the Effective Federal Funds Rate to the SOFR effective at the close of business on October 16, 2020. The consultation focuses on whether the ARRC should issue recommendations regarding the voluntary

exchange of cash compensation between bilateral counterparties to legacy interest rate swaptions and conventions for new interest rate swaption contracts.

- The ARRC sent a [letter](#) to the U.S. Treasury Department and the Internal Revenue Service about the [proposed regulations](#) regarding guidance on the transition. The letter describes the proposed regulations as “comprehensive” and “addressing most of the concerns raised by the ARRC in a manner that gives significant flexibility to taxpayers seeking to transition away from IBORs.” The letter respectfully requests that Treasury refine certain portions of the proposed regulations and consider additional recommendations with regards to one-time payments, the integration and hedging transaction rules, the OID regulations, fixed investment trusts, fast-pay stock, and accounting methods.

## U.S. Developments

- The Federal Housing Finance Agency announced [additional steps](#) Fannie Mae and Freddie Mac are taking as they transition away from LIBOR to SOFR. These steps include:
  - Single-family Uniform ARMs closed on or after June 1, 2020 must have ARRC-recommended fallback language referencing SOFR;
  - Single-family and multifamily ARMs based on LIBOR must have loan application dates on or before September 30, 2020; and
  - Single-family and multifamily ARMs based on LIBOR will not be purchased by Fannie and Freddie after December 31, 2020.
- Fannie Mae and Freddie Mac made related announcements ([Fannie Mae Single-Family](#), [Fannie Mae Multifamily](#), [Freddie Mac Single-Family](#), [Freddie Mac Multifamily](#)) stating they are incorporating ARRC-recommended fallback language into single-family ARMs to ensure contracts would continue to be effective if LIBOR is no longer usable. They also announced they plan to begin accepting ARMs based on SOFR later in 2020.
- On March 2, the New York Fed began publishing [30-, 90-, and 180-day SOFR Averages](#), as well as a SOFR Index. The New York Fed will publish SOFR Averages on its website shortly after SOFR is published around 8:00 a.m. Eastern Time on each day that is not broadly recognized by SIFMA as a holiday for U.S. government securities.
- The U.S. Treasury Department [announced](#) that it will issue a request for information to market participants in the first half of 2020 to understand the potential demand for a floating rate note based on SOFR and how it fits into Treasury’s goal of financing the government at the least cost over time.
- The Financial Accounting Standards Board [issued](#) an [Accounting Standards Update](#) that provides temporary optional guidance to ease the potential burden in accounting for reference rate reform. It provides expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships that reference LIBOR or another reference rate expected to be discontinued.

## Market Developments

- UK Financial Conduct Authority (FCA) issued a [statement](#) on coronavirus-related impacts on the transition, noting that “The central assumption that firms cannot rely on LIBOR being published after the end of 2021 has not changed and should remain the target date for all firms to meet... There has, however, been an impact on the timing of some aspects of the transition programmes of many firms. Particularly in segments of the UK market that have made less progress in transition and are therefore still more reliant on LIBOR, such as the loan market, it is likely to affect some of the interim transition milestones... Alongside other international authorities, the Bank of England, FCA and Working Group will continue to monitor and assess the impact on transition timelines, and will update the market as soon as possible.”
- The UK FCA also published a [statement](#) clarifying how it would announce LIBOR contractual triggers. Among other points, the statement notes that the announcement will be made via the [Regulatory News](#)

[Service](#) in conjunction with a message on their website, and it will be clear about the LIBOR currencies and tenders it relates to, as well as the cessation date.

- In February, there were several developments related to SOFR issuances. Goldman Sachs [executed](#) two SOFR swaptions. JPMorgan and the National Bank of Canada also [traded](#) the first SOFR versus Canadian overnight repo rate average (CORRA) cross-currency swap. Additionally, CME Group [reported](#) record SOFR futures average daily volume of 67,000 contracts.
- International Swaps and Derivatives Association (ISDA) launched a new [consultation](#) on how to implement pre-cessation fallbacks to determine if the 2006 ISDA Definitions should be amended to include fallbacks that would apply to all covered derivatives following the permanent cessation of an IBOR or a 'non-representative' pre-cessation event. The decision to re-consult was driven by the lack of market consensus on the [2019 consultation](#), and the [release of new information](#) by the UK FCA, ICE Benchmark Administration, and LCH on the length of time LIBOR may be published following a regulatory statement that the benchmark is no longer representative. The [deadline for responses](#) on the consultation is April 1.
- ISDA also published the [results](#) of a supplemental consultation on fallbacks for derivatives referencing Euro LIBOR and EURIBOR. ISDA plans to develop fallbacks based on the responses, for inclusion in its standard definitions based on the compounded setting in arrears rate with a backward shift and the five-year historical median approach to the spread adjustment for Euro LIBOR and EURIBOR.
- Additionally, ISDA published a [research paper](#) outlining the biggest challenges facing the financial industry during the transition from IBORs. The paper covers major upcoming developments in 2020, including the publication of new benchmark fallbacks for derivatives contracts and central counterparty changes in discounting and price alignment interest for certain currencies. ISDA also released a [table](#) identifying the various key workstreams related to IBOR reform.
- The International Capital Market Association (ICMA) released a [guide](#) to the transition to alternative reference rates in the international bond market. The guide describes ICMA's involvement with the transition, provides an overview of transition progress thus far and highlights priorities and next steps.

## International Developments

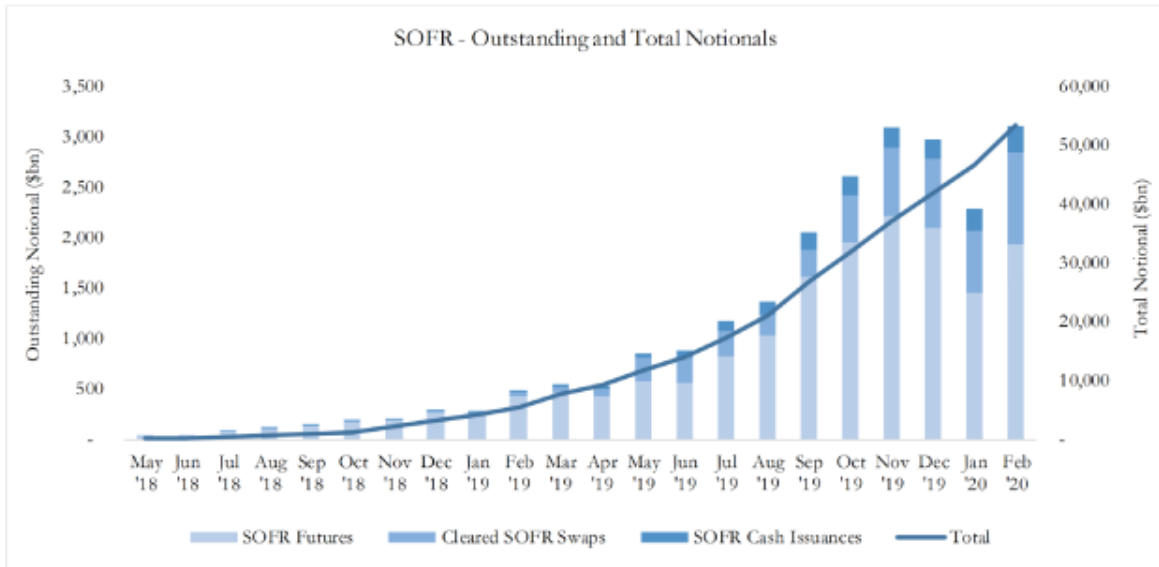
For more details on international efforts for reference rate reform, see the working groups in the [UK](#), [Switzerland](#), [Japan](#), [Hong Kong](#) the [euro area](#), and the [Official Sector Steering Group](#).

- The Financial Stability Board (FSB) published a [letter](#) from its Chair Randal Quarles to G20 Finance Ministers and Central Bank Governors. The letter highlights the transition away from LIBOR as a key priority for the FSB's work for the Saudi Arabian G20 meetings.
- The European Securities and Markets Authority (ESMA) published its [response](#) to the European Commission's (EC) Consultation on the review of the Benchmark Regulation (BMR). ESMA's response focuses on the cessation of critical benchmarks, parity between European Union and third-country benchmarks, and transparency. The EC will use the feedback to inform its recommendations on the effectiveness of the BMR in a report to be provided to the European Parliament and Council.
- The European Central Bank's Working Group on Euro Risk-Free Rates published a [report](#) on the transfer of liquidity from Euro Overnight Index Average (EONIA) to the Euro Short-Term Rate (€STR) in cash and derivatives markets. The report supplements the August 2019 [report](#) with clarifications on certain topics and additional recommendations for the transfer of EONIA's liquidity to €STR.
- The UK FCA and Bank of England (BoE) released several updates.
  - The UK FCA issued a "[Dear CEO](#)" [letter](#) to asset managers with its expectations as firms prepare for and contribute to an orderly transition away from LIBOR. The letter stressed the need for firms to begin transitioning now and to not wait for client instructions, regulatory relief, guidance, or legislative solutions.
  - BoE Executive Director for Markets Andrew Hauser [announced](#) that the BoE intends to publish a [daily SONIA Compounded Index](#) and will begin increasing [haircuts on LIBOR-linked collateral](#) it lends against in October 2020.
  - BoE also issued a [discussion paper](#) seeking views from sterling market participants on publishing the daily SONIA Compounded Index and a simple set of compounded SONIA

- Period averages. Publication of the SONIA Compounded Index is anticipated to commence by end-July 2020; and
- BoE and FCA issued a [joint letter](#) to trade associations on how LIBOR transition will affect their members and stakeholders and next steps.
  - The Working Group on Sterling Risk-Free Reference Rates published several updates, including:
    - A [statement](#) on how bond markets can use the BoE's proposed SONIA Compounded Index and the relevance for issuers' choice of conventions;
    - A [roadmap](#) outlining a path for the discontinuation of new Sterling LIBOR-based cash lending by end-Q3 2020; and
    - The [summary results](#) of a survey conducted by the BoE and FCA, as the secretariat of the Working Group on Sterling Risk-Free Reference Rates, with dealers in non-linear Sterling interest rate derivatives to understand the preferred approach for trading of interbank SONIA swaptions, caps and floors.
  - The Bank of Canada made an [announcement](#) stating it will take over responsibility for publishing CORRA, effective June 15, 2020.
  - The Reserve Bank of New Zealand released a [statement](#) supporting the selection of the Official Cash Rate as the fallback benchmark interest rate for New Zealand's benchmark interest rate, BKBM. BKBM is not being discontinued, as the New Zealand Financial Markets Association is improving the benchmark's reliability and robustness in line with international developments.
  - Deputy Governor of the Bank of Japan, Amamiya Masayoshi, delivered a [speech](#) regarding interest rate benchmark reform. The speech provided background on the transition, the progress made, and challenges ahead. It also highlighted Japan's planned initiatives going forward to ensure a smooth transition.
  - The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks published an [announcement](#) that Quick Corp will calculate and publish prototype term reference rates based on Japanese yen overnight index swaps.
  - The Basel Committee on Banking Supervision issued a [statement](#) that expressed its support for benchmark rate reforms, clarified the regulatory capital eligibility of capital instruments that are amended to reference alternative reference rates, and encouraged banks to evaluate whether changes to their risk management frameworks will be necessary to accommodate the transition to alternative rates.

## SOFR Market Liquidity

Since SOFR's publication, \$376bn notional in floating rate instruments tied to SOFR have been issued, with over \$265bn outstanding notional at February month-end.



(As of February 28, 2020; Source: [CME Group](#))

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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](mailto:arrc@ny.frb.org).

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