Alternative Reference Rates Committee

Guide on the Endgame for USD LIBOR

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ALTERNATIVE REFERENCE RATES COMMITTEE

On Monday, November 30, 2020, U.S. and UK regulators and LIBOR's administrator made a series of announcements regarding the end of U.S. Dollar (USD) LIBOR. Collectively, these announcements propose an endgame for USD LIBOR. They call for no new LIBOR contracts after end-2021, while giving legacy contracts sufficient time to wind-down.

But what do they mean and how do they fit with the work of the Alternative Reference Rates Committee (ARRC)? *Here's what you need to know.*

What were the key announcements?

Key Announcement by LIBOR's Administrator:

ICE Benchmark Administration (IBA)

IBA announced that it will consult on when to end the publication of various USD LIBOR tenors. If adopted, these proposed plans would cease the major USD LIBOR tenors in mid-2023 [overnight, 1M, 3M, 6M, 12M], and two little used USD LIBOR settings at the end of 2021 [1 week, 2M].

Subsequently, the IBA released the consultation on its intention to cease the publication of LIBOR settings. The consultation is open for feedback until January 25, 2021. After that, IBA "intends to share the results of the consultation with the FCA and to publish a feedback statement summarizing responses from the consultation shortly thereafter."

Key Announcements by Supervisors:

Federal Reserve Board, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency

These agencies issued supervisory guidance encouraging banks to stop entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021, in order to facilitate an orderly transition. The guidance explains that the June 30, 2023 cessation date should allow most legacy LIBOR contracts to mature, but noted that new USD LIBOR issuances after that "would create safety and soundness risks." Any issuance in 2021 should "either utilize a reference rate other than LIBOR or have robust fallback language that includes a clearly defined alternative reference rate after LIBOR's discontinuation."

The Financial Conduct Authority (FCA)

The FCA, LIBOR's regulator, welcomed and supported the proposed cessation dates, which would "incentivize swift transition, while allowing time to address a significant proportion of the legacy contracts that reference US$ LIBOR." The FCA said that it will coordinate with relevant authorities to consider whether and, if so, how to most appropriately limit new use of USD LIBOR by supervised entities in the UK. It noted that "We may exercise this power if we consider doing so protects consumers or market integrity" and that "We plan to consult in Q2 2021 on our proposed policy approach to the use of the power to prohibit some or all new use."

Statements Referring to these Key Announcements:

International Swaps and Derivatives Association (ISDA)

ISDA issued a statement about the key announcements, noting, "None of these statements constitute an index cessation event under the IBOR Fallbacks Supplement or the ISDA 2020 IBOR Fallbacks Protocol. Therefore, these statements will not trigger the fallbacks under the supplement or protocol (i.e., to the adjusted risk-free rate plus fixed spread adjustment) or have any effect on the calculation of the fixed spread adjustment. These statements will also not trigger fallbacks under the 2018 ISDA Benchmarks Supplement or its protocol."

The Federal Reserve Board

The Federal Reserve Board welcomed these developments which "lay out a path forward in which banks should stop writing new USD LIBOR contracts by the end of 2021, while most legacy contracts will be able to mature before LIBOR stops." Federal Reserve Board Vice Chair for Supervision Randall Quarles said the "plan ensures that the transition away from LIBOR will be orderly and fair for everyone—market participants, businesses, and consumers." Similarly, New York Fed President Williams and Official Sector Steering Group co-Chair John Williams said it represents, "critical steps in the effort to facilitate an orderly wind-down of USD LIBOR."

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The ARRC called the announcements a "major milestone," noting that it will accelerate market participants' use of SOFR. ARRC Chair Tom Wipf said they "fully align with the ARRC's efforts, propose a clear path for ending USD LIBOR, and reinforce the importance of the transition to robust reference rates like SOFR."

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Ok, so what does that actually mean? What are the key takeaways from these developments?

U.S. regulators are encouraging no new USD LIBOR contracts after the end of 2021, and a UK supervisor (LIBOR's regulator) is considering limiting new use of USD LIBOR. Concurrently, LIBOR's administrator (the IBA) is consulting on when to end the publication of USD LIBOR tenors, including ceasing publication of the major USD LIBOR tenors in mid-2023.

Taken together, these announcements propose a clear framework for ending USD LIBOR, and would facilitate an orderly transition. They call for market participants to stop writing new USD LIBOR contracts by the end of 2021, while allowing most legacy contracts to mature before LIBOR stops.

Given the announcements, what's on the horizon for USD LIBOR?

Overall:

The end of USD LIBOR is on the horizon. Everyone should continue to actively prepare to stop using LIBOR in new contracts by the end of 2021.

- The ARRC has a number of resources to support that effort, including recommended best practices and fallback language.
- IBA's consultation for the end date for LIBOR will cover all five currencies and will close on January 25, 2021. The FCA has indicated that clarity on all tenors should be possible as soon as practicable thereafter.
- Legacy contracts will have time to mature through mid-2023. FCA officials have indicated that they were confident that USD LIBOR "would be published on a representative basis" until end-June 2023, allowing legacy LIBOR contracts to run off.

Fallback Language:

When USD LIBOR ceases or is non-representative, contracts that contain fallback provisions will switch to a "fallback rate." A "fallback rate" is the rate that a contract indicates should be used if its base rate is not available.

ISDA's latest fallbacks for derivatives and the ARRC's recommended fallbacks for cash products referencing USD LIBOR, would both fall back to forms of SOFR plus a fixed spread adjustment.

- Note that, in the event that some USD LIBOR tenors stop publication or are found to be no longer representative before other tenors, ISDA's fallbacks would, where possible, interpolate using the still published representative LIBOR tenors; when all LIBOR tenors had stopped publication or become non-representative or where interpolation was not feasible, the fallback rate (which includes the fixed spread adjustments plus SOFR for USD LIBOR) would then apply.
- The fixed spread adjustments for USD LIBOR fallbacks will be based on a 5-year historical median of the spread between the relevant USD LIBOR tenor and SOFR.
    - The ARRC has stated its recommended spread adjustments for non-consumer cash products will be the same as ISDA's spread adjustments for USD LIBOR.
- The fallback rate referenced in ISDA's latest fallbacks is produced by Bloomberg in accordance with its IBOR Fallback Rate Adjustments Rule Book.

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Given the announcements, what's on the horizon for USD LIBOR? (cont.)

The Setting of Spread Adjustments [See Appendix on Page 5 fore relevant text directly from ISDA's IBOR Fallbacks Protocol and Bloomberg's IBOR Fallback Rate Adjustments Rule Book]:

The fixing of ISDA's spread adjustments takes place when there is a "Spread Adjustment Fixing Date" which can occur on or before the cessation date.

- *When* the spread is fixed is very much fact-dependent and can differ depending on whether an announcement relates to USD LIBOR entirely or just one or more tenors.

A "Spread Adjustment Fixing Date" for all USD LIBOR tenors would be triggered, and the ISDA spread adjustments would be fixed upon:

- An announcement by the IBA, FCA, the Federal Reserve, or other relevant official sector institution that USD LIBOR has ceased or will cease permanently; or,
- An announcement by the FCA that USD LIBOR is no longer or will, on a specified future date, no longer be "representative" of its underlying market. As indicated on Page 1, ISDA stated that the November 30 announcements did not trigger the calculation and fixing of ISDA's spread adjustments. IBA's November 30 announcement only signaled *an intention to consult* on USD LIBOR cessation dates and was not an announcement that USD LIBOR would cease.

IBA has stated that it expects to close its consultation on January 25, 2021, share results with the FCA, and publish feedback summarizing responses from the consultation shortly after. The FCA has indicated that the consultation will cover all five currencies, that it *"should make it possible to determine and make announcements on the future path for all five currencies simultaneously… [and] everyone's aim will be to provide clarity to the market on all 35 settings as soon as practicable."*

- So if IBA announces the cessation dates for all currencies and tenor settings including USD LIBOR at the end of the consultation, then a Spread Adjustment Fixing Date—and in turn, the fixing of the ARRC's recommended spread adjustments for non-consumer cash products and of ISDA's spread adjustment for USD LIBOR derivatives—would occur. This assumes that no prior announcement relating to USD LIBOR has occurred and that any IBA announcement relates to all USD LIBOR tenors.

To be clear, the date that ISDA's spread adjustment is fixed is not the same as when the fallback rate is applied.

- In the case of USD LIBOR, if the outcomes of the IBA consultation are that the one week and two month tenors will cease after December 2021 and the remaining tenors will cease after June 2023, the fallback rate (which comprises the fixed spread adjustment) would only be applied for all tenors after June 2023.
- Between the end of December 2021 and the end of June 2023, if any contract subject to the latest ISDA fallback terms refers to the *one week or two month tenors*, the rate will be determined by linear interpolation.

- ISDA described the endgame for USD LIBOR in this respect in three key periods: now through end-2021; end-2021 to end-June 2023 and end-June 2023 onwards.

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Given the announcements, what's on the horizon for USD LIBOR? (cont.)

Proposed Legislation:

While most legacy USD LIBOR contracts will be able to mature by mid-2023 under the proposed approach IBA plans to consult on, a number will remain, including those without effective means to replace LIBOR.

- The ARRC continues to pursue its legislative proposal with New York State and strongly believes that legislation remains necessary to address that set of contracts. The ARRC's proposed legislation is narrowly targeted as it is focused on legacy contracts that do not have effective fallback provisions that will work when LIBOR becomes unusable.
- This proposed legislation remains critical for that set of contracts to minimize legal uncertainty and adverse economic impacts, so the ARRC will continue to work to have that legislation be taken up.
- The ARRC had originally sought for its proposal to be included as part of the Governor's Budget process last year, before the legislative session in New York was disrupted by the COVID crisis. The potential adjustment to the timing of key LIBOR tenors would essentially offset the roughly 1-year delay in the ARRC's originally hoped-for timing of a legislative solution.

Recommended Best Practices:

- The ARRC's Recommended Best Practices provide critical timelines for the transition from USD LIBOR to SOFR. They are designed to prepare market participants for no new LIBOR use as soon as the ARRC deemed was practicable, in a way that minimizes market disruption and supports a smooth transition.
- They outline achievable dates for market participants to identify their exposures, implement fallback language, prepare systems and business processes, and cease new use of LIBOR.
- That is fully consistent with the U.S. supervisory guidance.
- The ARRC will assess whether any alterations to its Best Practice Recommendations are warranted. However, in light of U.S. regulators' guidance that new issuance of LIBOR instruments should stop as soon as is practicable and in no case later than end-2021, the ARRC notes that it developed its recommended timelines for stopping new use of LIBOR instruments on the basis of what it considered to be practicable, with all recommended timelines ahead of end-2021.
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Resources

For more information see:

nyfed.org/arrc

ISDA Endgame Webinar (transcript)

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Appendix

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The following is the relevant content directly from the ISDA IBOR Fallbacks Protocol and Bloomberg's IBOR Fallback Rate Adjustments Rule Book regarding the triggering of an "Index Cessation Event" and its effective date.

From ISDA's Protocol (Pages 49 and 50):

"Index Cessation Effective Date" means, in respect of a Relevant IBOR (or, if either the Singapore dollar swap offer rate or the Thai baht interest rate fixing is the Relevant IBOR, U.S. dollar LIBOR) and one or more Index Cessation Events, the first date on which the Relevant IBOR (or, if either the Singapore dollar swap offer rate or the Thai baht interest rate fixing is the Relevant IBOR, U.S. dollar LIBOR) is either (a) in respect of a Relevant LIBOR (or, if the Relevant IBOR is the Singapore dollar swap offer rate or the Thai baht interest rate fixing, in respect of U.S. dollar LIBOR), Non-Representative by reference to the most recent statement or publication contemplated in subparagraph (c) of the definition of "Index Cessation Event" below and even if such rate continues to be provided on such date or (b) no longer provided. If the Relevant IBOR (or, if either the Singapore dollar swap offer rate or the Thai baht interest rate fixing is the Relevant IBOR, U.S. dollar LIBOR) ceases to be provided on the Relevant Original Fixing Date but it was provided (and, in respect of a Relevant LIBOR (or, if the Relevant IBOR is the Singapore dollar swap offer rate or the Thai baht interest rate fixing, in respect of U.S. dollar LIBOR), is not Non-Representative) at the time at which it is ordinarily observed, then the Index Cessation Effective Date will be the next day on which the rate would ordinarily have been published. An Index Cessation Effective Date may also occur in accordance with paragraph 6(d), subparagraph 6(e)(ii) or subparagraph 6(e)(iii) above.

"Index Cessation Event" means, in respect of a Relevant IBOR

a) a public statement or publication of information by or on behalf of the administrator of the Relevant IBOR announcing that it has ceased or will cease to provide the Relevant IBOR permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide the Relevant IBOR;
b) a public statement or publication of information by the regulatory supervisor for the administrator of the Relevant IBOR, the central bank for the currency of the Relevant IBOR, an insolvency official with jurisdiction over the administrator for the Relevant IBOR, a resolution authority with jurisdiction over the administrator for the Relevant IBOR or a court or an entity with similar insolvency or resolution authority over the administrator for the Relevant IBOR, which states that the administrator of the Relevant IBOR has ceased or will cease to provide the Relevant IBOR permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide the Relevant IBOR; or
c) if the Relevant IBOR is sterling LIBOR, Swiss franc LIBOR, U.S. dollar LIBOR, euro LIBOR, Japanese yen LIBOR, the Singapore dollar swap offer rate or the Thai baht interest rate fixing, a public statement or publication of information by the regulatory supervisor for the administrator of such Relevant IBOR (or, if the Relevant IBOR is the Singapore dollar swap offer rate or the Thai baht interest rate fixing, by the regulatory supervisor for the administrator of U.S. dollar LIBOR) announcing that (i) the regulatory supervisor has determined that such Relevant IBOR is no longer, or as of a specified future date will no longer be, representative of the underlying market and economic reality that such Relevant IBOR is intended to measure and that representativeness will not be restored and (ii) it is being made in the awareness that the statement or publication will engage certain contractual triggers for fallbacks activated by pre-cessation announcements by such supervisor (howsoever described) in contracts, provided that, if either the Singapore dollar swap offer rate or the Thai baht interest rate fixing is the Relevant IBOR, references to the "Relevant IBOR" in subparagraphs (a), (b) and (c)(i) above of this definition of "Index Cessation Event" will be deemed to be references to U.S. dollar LIBOR.

An Index Cessation Event may also occur in accordance with paragraph 6(d), subparagraph 6(e)(ii) or subparagraph 6(e)(iii) above.

From Bloomberg's Rule Book (Pages 8 and 11)

"IBOR Cessation Trigger Date" means, with respect to an IBOR and with respect to the defined terms used in this Rule Book, the date on which there is:

i. a public statement or publication of information by or on behalf of the IBOR Administrator announcing that it has ceased or will cease to provide the IBOR permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide the IBOR; or
ii. a public statement or publication of information by the regulatory supervisor for the IBOR Administrator, the central bank for the currency of the IBOR, an insolvency official with jurisdiction over the administrator for the IBOR, a resolution authority with jurisdiction over the administrator for the IBOR or a court or an entity with similar insolvency or resolution authority over the administrator for the IBOR, which states that the IBOR Administrator has ceased or will cease to provide the IBOR permanently or indefinitely, provided that, at the time of the statement or publication, there is no successor administrator that will continue to provide the IBOR; or
iii. if the IBOR is Sterling LIBOR, Swiss Franc LIBOR, U.S. Dollar LIBOR, Euro LIBOR or Yen LIBOR only, a public statement or publication of information by the regulatory supervisor for the IBOR Administrator of such IBOR announcing that (a) the regulatory supervisor has determined that such IBOR is no longer, or as of a specified future date will no longer be, representative of the underlying market and economic reality that such IBOR is intended to measure and that representativeness will not be restored and (b) it is being made in the awareness that the statement or publication will engage certain contractual triggers for fallbacks activated by pre-cessation announcements by such supervisor (howsoever described) in contracts;

"Spread Adjustment Fixing Date" means, with respect to an IBOR and Tenor, the earlier of,

i. the IBOR Cessation Trigger Date, and
ii. the Tenor Cessation Trigger Date or, if later, the last date for which there is both a Live Tenor that is shorter than such Tenor and a Live Tenor that is longer than such Tenor;