ARRC

Alternative Reference Rates Committee | Newsletter

April - May 2021

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 the risk-free rates transition in the U.S. and global markets.

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Top 3 Takeaways

1. **The ARRC made significant progress in its work related to Secured Overnight Financing Rate (SOFR) term rates. Specifically, the ARRC published key principles in April, released a set of market indicators for an ARRC-recommended forward-looking SOFR term rate in early May, and most recently, the ARRC concluded its RFP Process, selecting CME Group as the administrator that it plans to recommend for a forward-looking SOFR term rate, once the market indicators are met.** The market indicators provide clear guidance that would allow the ARRC to recommend a SOFR-based term rate relatively soon.
   - The market indicators the ARRC will consider in order to recommend a term rate are:
     1. Continued growth in overnight SOFR-linked derivatives volumes
     2. Visible progress to deepen SOFR derivatives liquidity, consistent with ARRC best practices:
        a) Offering electronic market-making and execution in SOFR swaps and swap spreads
        b) Changing the market convention for quoting USD derivative contracts from LIBOR to SOFR
        c) Making markets in SOFR-linked interest rate volatility products (including swaptions, caps, and floors)
     3. Visible growth in offerings of cash products, including loans, linked to averages of SOFR, either in advance or in arrears.
   - The ARRC identified CME Group's submission as the strongest proposal after a thorough evaluation of the RFP responses. That announcement on CME Group should allow market participants to plan ahead for the recommendation of the CME Group as the term rate administrator soon.
     - In conjunction with its work towards a final recommendation of a SOFR term rate, the ARRC also plans to recommend best practices for use of the term rate, including for example as a fallback rate for legacy cash products referencing LIBOR and in new loans where the borrowers otherwise have difficulty in adapting to the new environment.

2. **In early April, New York State Governor Andrew Cuomo signed legislation addressing the issue of legacy LIBOR contracts that mature after mid-2023 and do not have effective fallbacks – adding a new Article 18-C to the General Obligations Law in New York State.** This legislation will be crucial in minimizing legal uncertainty and adverse economic impacts associated with the transition, providing greater certainty to investors, businesses, and consumers as the financial system moves away from LIBOR.

- The text of the legislation was [initially presented by the ARRC] last year, and the ARRC commends Senator Kevin Thomas and Assemblyman Kenneth Zebrowski for leading efforts to pass the bill in New York State.
- In response to the legislation passing into law, ARRC Chair Tom Wipf said, *"By establishing a targeted solution for tough legacy contracts, this legislation will significantly reduce operational and legal risks for many market participants and help them seamlessly transition to the Secured Overnight Financing Rate."*

3. **Both the official sector and ARRC members continued to underscore the urgency of transitioning in a sustainable way and necessary actions in order to do so.**
    - ***On the official sector side:*** During the second in the ARRC's series of webinars The SOFR Symposium: The Final Year, Federal Reserve Bank of New York President John C. Williams and Bank of England Governor Andrew Bailey both highlighted the weaknesses of the markets underlying LIBOR. Bailey warned market participants about credit sensitive rates that rely on similar markets to LIBOR noting that *"it is not clear to what extent alternative credit sensitive benchmarks have truly addressed the weaknesses of Libor."* Building off of this, Williams underscored the need to build a *"strong and deep foundation of reference rates that will be rock-solid"* in order to avoid reintroducing the same vulnerabilities and risks Libor faced. Williams emphasized that *"no other rate has the depth of transactions of the repo market that underlies SOFR"* and Bailey reinforced the need to *"transition in a way that minimizes the risk of us having to undertake a similar exercise in the future."*
    - ***From the ARRC member perspective:*** leadership from the Association for Financial Professionals, the National Association of Corporate Treasurers, and the U.S Chamber of Commerce sent a letter to Treasury Secretary Yellen, Federal Reserve Board Chairman Powell, New York Fed President Williams, Securities and Exchange Committee Chairman Gensler, and Commodity Futures Trading Commission (CFTC) Acting Chairman Behnam. The letter highlighted the various challenges that the LIBOR transition represents to the community of nonfinancial corporates (NFCs) and asked for a meeting to discuss the specific challenges of the LIBOR transition to NFCs.
        - Specifically, the letter noted that *"Many NFCs currently struggle in obtaining from their lenders specific proposals and processes for how their loan agreements will be amended and the mechanics of how the ARRC's recommended SOFR rate will substitute for LIBOR" and asked for "guidance in encouraging banks and securities underwriters to accelerate their ability to provide NFCs with relevant transition materials and to be at the ready to offer NFCs with SOFR-indexed financings."*

Other ARRC Developments

- The ARRC held the second in a series of webinars, The SOFR Symposium: The Final Year, on May 11. The event built on the ARRC's initial SOFR Symposium in March by highlighting the significance of this transition for financial stability and the importance of moving off of LIBOR in a sustainable way. A recording from the event is available here.
    - The event opened with remarks by Federal Reserve Bank of New York President John C. Williams and Bank of England Governor Andrew Bailey, followed by a moderated discussion about 2021 priorities, progress to date, term rates, credit sensitivity, and LIBOR legislation.
    - This was followed by a discussion with banks and borrowers facilitated by ARRC Chair Tom Wipf on SOFR, term rates and loan market developments. That discussion featured representatives from JPMorgan Chase, Wells Fargo, the Association of Financial Professionals, Ford Motor Company, and Prologis. The ARRC conducted a survey of NFCs, which found that nonfinancial corporates were seeking a range of SOFR options but were not being offered them.
- The ARRC also announced its third event in its SOFR Symposium series, which will take place on June 8, 2021. The event will open with remarks by CFTC Acting Chair Behnam, followed by a discussion featuring leadership from both the official and private sectors.
    - The link to register for this event is here.
- The ARRC released the Guide to Published SOFR Averages in order to provide market participants – and nonfinancial corporates in particular – with key information on the LIBOR transition. The Guide

includes how the published SOFR Averages can be used today and what factors market participants should consider before selecting the alternative rate they use.

- The ARRC and its member firms wrote to the U.S. Securities and Exchange Commission to request no-action relief, interpretive guidance or a rulemaking, as appropriate, regarding treatment of security-based swaps that are amended or transitioned to ARRs due to the discontinuation of IBORs. The ARRC requests that Commission staff provide interpretive guidance confirming that a market participant would not be required to file an amendment to its Beneficial Ownership Forms as a result of an IBOR Transition Mechanism or, in the alternative, no-action relief from such requirement.
- The ARRC updated its Frequently Asked Questions about the ARRC's work and the overall transition.

U.S. Developments

- The House Committee on Financial Services convened a hearing titled, "The End of LIBOR: Transitioning to an Alternative Interest Rate Calculation for Mortgages, Student Loans, Business Borrowing, and Other Financial Products."
    - The hearing brought together numerous government agencies with representatives from the Federal Housing Finance Agency, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, and the Treasury Department appearing as witnesses.
    - In his testimony, Federal Reserve Board General Counsel Mark Van Der Weide explained that legacy LIBOR-based contracts is a key transition issue and that *"Federal legislation would establish a clear and uniform framework, on a nationwide basis, for replacing LIBOR in legacy contracts that do not provide for an appropriate fallback rate."*
- The Federal Reserve Board of Governors published its semiannual Supervision and Regulation Report to inform the public about efforts to promote safety and soundness in the banking system. The report included LIBOR transition preparedness as an upcoming large financial institution supervisory priority, highlighting the supervisory guidance for examiners to use in assessing LIBOR transition plans.

Market Developments

- CME Group released several updates including:
    - March report highlighting record SOFR futures average daily volume of 112,000 contracts and SOFR futures average daily volume up 82% YoY in Q1 2021 compared to Q1 2020.
    - Launch of interest rate futures based on the Central Bank of Mexico's Overnight TIIE funding rate available for trading on May 24, 2021. These contracts align with the Central Bank of Mexico's objectives to develop ARRs and establish a domestic funding curve.
    - Announcement of publication of CME Term SOFR Reference Rates for 1-month, 3-month and 6-month tenor, aligned with the ARRC's key principles.

International Developments

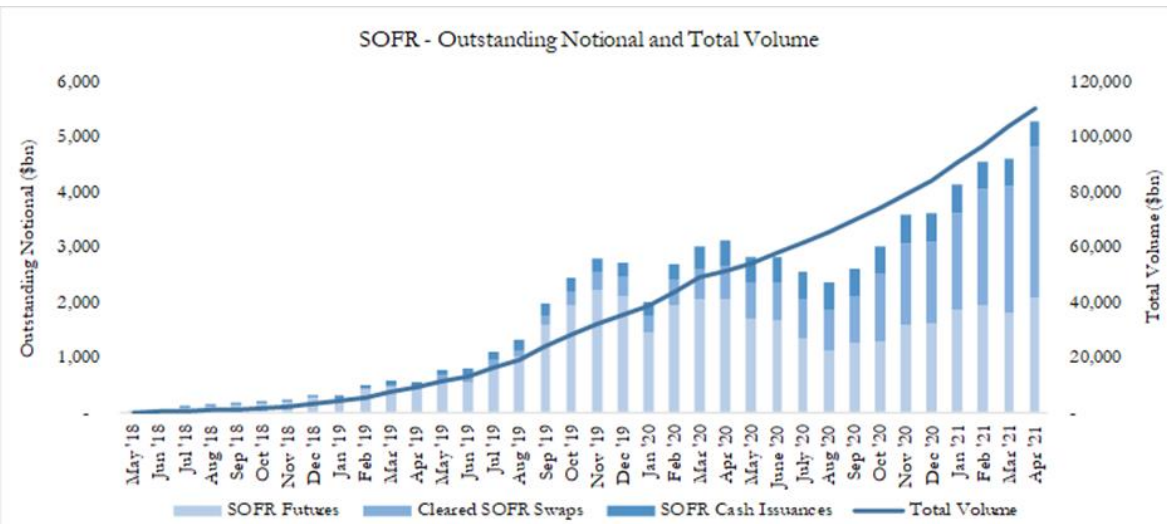
For more details on international efforts for reference rate reform, see the working groups in the U.K., Switzerland, Japan, Hong Kong the euro area, and the Official Sector Steering Group.

- The Working Group on Sterling Risk-free Reference Rates released several updates including:
    - Considerations for active transition of contracts to SONIA ahead of GBP LIBOR cessation, including a comparison between reliance on ISDA's IBOR fallbacks and active transition for GBP bilateral swaps.
    - Operational considerations for fallbacks in uncleared linear derivatives to inform planning and preparation for the operationalization of fallbacks.
    - Letter to HM Treasury seeking an update on whether the Government intends to introduce safe harbor provisions to support the wind-down of critical benchmarks.
    - Paper considering how a GBP structured products market could be designed using compounded in arrears SONIA, and to support the transition of legacy structured products using GBP LIBOR.

- The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks [updated](#) its *Roadmap to Prepare for the Discontinuation of Japanese Yen LIBOR* to include a transition plan for interest rate swaps referencing Japanese yen LIBOR and maturing after the end of 2021.
- QUICK Benchmarks Inc. began [publishing](#) production rates for the Tokyo Term Risk Free Rate (TOFR) on April 26, 2021. The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks determined QUICK Corp. as a suitable calculating and publishing entity of Term Reference Rates in February 2020 after consultation.
- The Bank of Canada, administrator of the Canadian Overnight Repo Rate Average (CORRA), [published](#) its 2020 Annual Report. The report highlighted interest rate benchmark reform, including the Bank of Canada's support in transitioning the Canadian financial system to CORRA, which it expects to eventually become the primary Canadian interest rate benchmark.
- The Bank of Canada began [publishing](#) CORRA Compounded Index and the first quarterly summary of publication errors on April 6, 2021.
- The National Working Group on Swiss Franc Reference Rates (NWG) published an expert opinion on the use of ["non-cumulative" compounded SARON under Swiss law](#). NWG also published an updated version of its an updated version of its [Starter Pack](#), providing an up to date overview about all relevant aspects of the transition.

SOFR Market Liquidity

Since SOFR's publication, approximately $990bn notional in floating rate instruments tied to SOFR have been issued, with over $487bn outstanding notional at April month-end.



As of May 13, 2021
Source: [CME Group](#), [LCH](#), [ICE](#))
Note: Cleared SOFR swaps figures represent one side of each transaction (single-sided)

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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