November 22, 2018

Alternative Reference Rates Committee ("ARRC")

Via email submission to: arrc@ny.frb.org

Re: Consultation Response - FRNs

TD Bank Group ("TD") welcomes the opportunity to respond to the ARRC Consultation regarding more robust LIBOR fallback contract language for new issuances of LIBOR floating rate notes ("FRNs"). TD recognizes the need for the identification of industry standards and best practices in determining effective fallback language for the identification of alternative rates and calculations of effective non-value transfer spreads as a means to prevent market disruption in the event that LIBOR does not exist or is not viable beyond 2021. In addition, TD appreciates the efforts of the ARRC Floating Rate Notes Working Group in developing a consultation that takes into consideration discussions in the derivatives market, given the benefits of consistency across cash and derivatives products.

As an overall caveat, while we understand that the Federal Reserve Bank of New York ("FRBNY") is actively working to develop forward-looking term SOFR and this work effort is supported by TD, without an existing market at this time it is challenging to provide a clear view on whether we can practically affirm the waterfall. With that in mind, the response to this consultation is an initial TD view but may be subject to change as more information becomes available.

Responses to Questions:

Triggers

1(a): Should fallback language for FRNs include any of the pre-cessation triggers? If so, which ones?

While TD supports pre-cessation triggers and recognizes the value they add from a contractual perspective (particularly in avoiding a zombie LIBOR situation), we would want the language to be as objective as possible to mitigate uncertainty for an issuer or calculation agent when exercising their discretion around the trigger. Our key concern is alignment with the industry with respect to the timing of any determination that a trigger has taken effect.

We believe that trigger 3, the stale data trigger, is sufficiently clear to limit discretion.

Trigger 4, the zombie trigger, could be drafted with more certainty of terms by referring to a set number of panel banks (e.g., less than six) rather than referencing the administrator's submission policy which could be subject to change.
Trigger 5, the regulatory fail-safe trigger, is welcomed as an option of last resort in the event that circumstances would otherwise warrant a migration away from a benchmark even though none of the other more prescriptive triggers had been triggered. However, as currently drafted, it may be both too broad and too narrow. Broad in that it leaves open the possibility for issuers to interpret certain statements by a regulator in different ways. As an example, an issuer could theoretically interpret statements already made by the FCA regarding LIBOR as sufficient for this trigger. Consider strengthening the language to provide more certainty, such as referencing the existence of a public statement explicitly prohibiting the use of such Benchmark which would mitigate litigation risk for an issuer or calculation agent calling the trigger. Narrow in that it refers only to the regulator with authority over the administrator whereas circumstances could vary by jurisdiction creating a potential for one market desiring a shift without any ability to take action until the regulator in another market makes such determination.

Consider also adding more flexibility to commence action in advance of a stated prohibition date by allowing the trigger to take effect up to a set period (such as six months) prior to such stated prohibition date. Such clarity coupled with lead time would assist with operational preparedness.

1(b): Indicate whether any concerns you have about these pre-cessation triggers relate to differences between these triggers and those for standard derivatives or relate specifically to the pre-cessation triggers themselves?

The primary concern with the pre-cessation triggers (triggers 3, 4 and 5) relate to the basis risk that would arise between the fallback rate that would then be in effect upon implementation for FRN's that would at that point differ from the original LIBOR rates still referenced in the derivative hedges. The secondary concern would be the risk of exercising discretion to act on such early triggers as such action, or even the failure to act, could expose issuers to litigation and other risks. To some extent, such litigation risk may be reduced provided such discretion is exercised consistently with industry convention.

1(c): If pre-cessation triggers are not included, what options would be available to manage the potential risks involved in continuing to reference a Benchmark whose regulator has publicly determined that it is not representative of the underlying market or a Benchmark permanently or indefinitely based on a number of submissions that the Benchmark's administrator acknowledges to be insufficient to allow for production in a standard manner?

No obvious risk management strategies if market participants remain locked in which is why TD would advocate to include the regulatory fail-safe trigger with discretion for any jurisdictional regulator to take action if warranted.
Replacement Benchmark

2: If the ARRC has recommended a forward-looking term rate, should the rate be the primary fallback for FRNs referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR?

In general, a forward-looking term rate would be most similar to what we currently use for our notes and would be preferred as the primary fallback option for FRNs provided such rate corresponding to the relevant interest accrual period were available based on a sufficiently robust number of market transactions.

3(a): Should Compounded SOFR be the second step in the waterfall? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR?

TD would be supportive of Compounded SOFR being the second step in the waterfall, provided it is based on a compounded average daily SOFR over the relevant period as opposed to a compounded spot SOFR rate (which is subject to greater risk of volatility, so any temporary spikes or dips would otherwise be magnified through compounding). Operational risks are higher with using the compounding methodology used in the ISDA definition of USD-SOFR-COMPOUND in that current systems do not support such automated calculations, although TD expects to be able to resolve such current challenges by the time a trigger event occurs. Otherwise, this option may only be feasible if it were a published rate. We expect some investors may prefer a published rate for similar reasons.

With respect to the second part of the question, if ISDA implements fallbacks referencing compounded SOFR as opposed to overnight SOFR, this would be expected to have a positive impact on the preference for Compounded SOFR.

3(b): If you believe that Compounded SOFR should be included, which compounding period is preferable (“in arrears” or “in advance”)? Would this preference be influenced by whether ISDA implements fallbacks referencing compounding SOFR “in arrears” or “in advance”?

It’s difficult to anticipate what would be most appealing to investors given that there is no precedent for Compounded SOFR, however our initial view is a preference for “in arrears”. The FRBNY has indicated that the market's highest priority is for the rate to be reflective of the interest period. Since this option allows the calculation to retroactively include actual changes in market rates during the interest period, compounding in arrears would be most aligned to this priority. Additionally, compounding in arrears is similar to OIS, which market participants may already be familiar with.

The disadvantage to in arrears is that the rate is not known until the end of the interest period which creates an operational challenge and additional risk from the uncertainty of interest amounts. Operationally, the processing time required to perform settlements after the data becomes known can be addressed by implementing a lock-out period. Investors may be better positioned to handle the uncertainty with respect to amounts that would be received compared to borrowers who may require more certainty in knowing in advance the amounts that they would be required to pay.
Compounding in advance is most similar to how LIBOR FRNs are structured, however this poses the risk of using calculated rates that may be inconsistent with the current environment if there is a steep fall or risk in interest rates.

4(a): Would an overnight rate that remains in effect for the entire interest period be an acceptable option for investors, issuers and agents?

No, not if such a spot rate remains fixed throughout the period due to the volatility risk in that a spot rate may spike considerably more near the last days of a month or quarter, and particularly during times of financial stress.

Current SOFR transactions are structured with a daily reset rate and a two or four-day lock-out. This would be preferable to an overnight rate that remains in effect for the entire interest period.

TD would prefer a simple average arrears SOFR.

4(b): Should the waterfall include Compounded SOFR and Spot SOFR and/or simple average of SOFR (not included in the waterfall at this time)? If only one of these options is included, which is preferable? Would this preference be influenced by whether ISDA implements fallbacks referencing compounded SOFR or overnight SOFR?

Once Compounded SOFR becomes calculatable or is published, it is preferable to simple average of SOFR. However, if Compounded SOFR is not available, TD would prefer simple average SOFR instead of Spot SOFR for the reasons discussed in 4(a).

5: In the future circumstance where there is no SOFR-based fallback rate, is the replacement rate determined by the Relevant Governmental Body the best alternative at this level of the waterfall?

Yes, TD agrees with this.

6(a): In the future circumstance where there is no SOFR-based fallback rate and the Relevant Governmental Body has not recommended a replacement rate for FRNs, is the fallback for SOFR-linked derivatives set forth in the ISDA definitions the best alternative at this level of the waterfall?

Yes, as it is understood that the approach proposed by ISDA would also be to look to the replacement rate as determined by the Relevant Governmental Body.

6(b): Should this step in the waterfall refer expressly to OBFR and then the FOMC Target Rate rather than refer to the fallback rate for SOFR-linked derivatives in the ISDA Definitions?

No, we are of the view that non-SOFR fallback rates should not be included expressly in FRNs.
7: Should the issuer or its designee have the ability to over-ride the ISDA fallback for SOFR-linked derivatives in the ISDA definitions at this level of the waterfall if it determines that another rate that is an industry-accepted successor rate for FRNS exists at such time?

Although this could be useful, in practice, exercising such discretion may expose issuers to litigation and other risks.

8: Do you believe that ARRC should consider recommending a spread adjustment that could apply to cash products, including FRNs?

Yes.

9: Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the spread waterfall when the Unadjusted Replacement Rate is equivalent to the ISDA fallback rate?

Yes, this would make sense from an operational perspective.

10: If ARRC does not recommend a spread adjustment, should the issuer have the ability to determine the spread adjustment (or, if step 2 is applicable, override the spread adjustment for derivatives fallbacks in the ISDA Definitions) and select a spread adjustment that would result in a rate that is an industry-accepted successor rate in FRNs at such time?

As with question 7, although this may be useful to have such discretion, in practice, exercising such discretion may expose issuers to litigation and other risks. It would be strongly preferred that the spread adjustment be determined through a collaborative industry process.

11: Whether as issuer or calculation agent, would your institution be willing to (i) determine whether the proposed triggers have occurred, (ii) select screens where reference rates or spreads are to be found, (iii) make calculations of a rate or spread in the absence of published screen rates, (iv) interpolate term SOFR if there is a missing middle maturity and (v) make decisions in step 6 of the Replacement Benchmark waterfall and step 3 of the Replacement Benchmark Spread waterfall?

We expect that greater objectivity on each of these matters would increase institutions’ willingness to make such determinations. Matters requiring judgment or subjectivity may expose issuers and calculation agents to litigation and other risks.

General Feedback

No further comments to add at this time.
TD wishes to reiterate our appreciation to the ARRC Floating Rate Notes Working Group for the opportunity to provide feedback on the FRN Consultation. We are happy to discuss our responses and to provide any additional information that may be helpful.

Thank-you for your consideration of these important issues to market participants.