BMO Capital Markets

February 4, 2019

Alternative Reference Rates Committee ("**ARRC**")

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

Re: Consultation Response – New Issuances of LIBOR Securitizations

BMO Capital Markets ("BMO CM") welcomes the opportunity to respond to the ARRC Consultation for New Issuances of LIBOR Securitizations. BMO CM recognizes the need for establishing industry standards and best practices in transitioning LIBOR-based securities to a replacement benchmark as a means to prevent market disruption in the event that LIBOR does not exist or is not viable beyond 2021. Our responses are as follows:

Question 1: Which securitization asset classes are you referring to in your response to this consultation if limited to only certain asset classes? If there are particular features of these asset classes that shape your responses to the questions in this survey, please describe them to the extent possible.

Response: BMO Capital Market's response to the Consultation questions is not limited to particular asset classes.

Question 2: The ISDA triggers contemplate a permanent cessation of LIBOR as of a date certain which may be announced in advance (the "Cessation Date"), at which point the transition from LIBOR to SOFR would occur. As there may be operational challenges for securitizations as both assets and liabilities will have to be transitioned, some have asked for the ability to transition in advance of the Cessation Date in order to address any operational issues that may arise. Specifically, the Designated Transaction Representative (as defined in Appendix I) will have the ability to pick one date within a 30-day period prior to the Cessation Date to facilitate an orderly transition. Do you feel the inclusion of this ability to transfer prior to the Cessation Date is needed? If so, please explain the specific, critical and tangible needs that support its inclusion?

Response: BMO CM has the following comments:

1) The Consultation should include provisions contemplating early adoption of the Replacement Benchmark.
2) Primarily for operational and financial reasons[1], BMO Capital Markets is of the view that allowing the Designated Transaction Representative to choose a Benchmark Replacement Date would be a useful feature of the fallback language.
3) BMO CM further believes securitization parties may find it useful to align a Benchmark Replacement Date with timing cycles of specific transactions, such as a monthly settlement or calculation date.
4) The ability to designate a Benchmark Replacement Date will allow parties to provide a date certain and eliminate the variability inherent in the current "later of" definitions.

[1] Operational reasons include avoiding mass conversion on a single date. Financial reasons include aligning the Benchmark Replacement Date of (i) underlying assets, (ii) SPE securities, and (iii) hedging instruments).

5) BMO CM is of the view that controls around the Designated Transaction Representative's ability to assign the Benchmark Discontinuation Event and/or Benchmark Replacement Date, could be put in place to help ensure the parties do not take advantage of the discretion provided. Controls could include limiting the assignment to certain contractually relevant dates (e.g. settlement/payment date or calculation/determination date) within a window (e.g. 60 days) prior to the technical Benchmark Discontinuation Event/Benchmark Replacement Date.

Question 3(a): Should fallback language for Securitizations include any of the pre-cessation triggers (clauses (3), (4), (5) and (6) of the Benchmark Discontinuance Event definition)? If so, which ones? Also, please identify any pre-cessation triggers that you do not believe should be utilized for a particular securitization product and explain why.

Response: BMO CM if of the view that all precessation triggers should be included in the proposed fallback language for Securitizations.

Question 3(b): Please indicate whether any concerns you have about these pre-cessation triggers relate to the differences between these securitization triggers and those for standard derivatives or whether your concerns relate specifically to the pre-cessation triggers themselves.

Response: BMO CM's primary concerns relate to differences between pre-cessation securitization triggers and derivatives triggers. Specifically, BMO CM is of the view that consistency between securitization and derivatives fallback provisions is more of a priority than the specific definitions and priority of the securitization fallback provisions independently. Many securitization deals include derivative instruments. Approaching the LIBOR transition differently for those related instruments will create disruption and transfer of value, in addition to the LIBOR transition itself.

BMO CM would like to note, while some of our responses to this consultation will express preferences for certain definitions or waterfall provisions with respect to securitization fallbacks, consistency with derivatives fallbacks remains our top priority. As such, it may be appropriate to permit the applicable securitization fallback provisions to depend on whether the transaction includes derivatives instruments.

Question 3(c): If you believe that the pre-cessation trigger in clause (6) (Asset Replacement Percentage) should not be retained, please note any specific concerns leading to this conclusion. If you believe that it should be retained, are there any changes you believe should be made to this trigger? Please explain.

Response: BMO CM is of the view that the Asset Replacement Percentage pre-cessation trigger provides the originator/servicer/asset manager with greater discretion over Benchmark Discontinuance Event/Benchmark Replacement Date than other triggers. It may therefore be prudent to provide safeguards against opportunistic behavior, such as disallowing the party in control of the Asset Replacement Percentage from being the Designated Transaction Representative.

***Question 3(d)**: If you believe the pre-cessation trigger in clause (6) (Asset Replacement Percentage) should be retained, how would you address concerns that it could result in a transfer of value in a transaction where the Designated Transaction Representative has the ability to change the benchmark used on the underlying assets and, as a result, determine the timing of this pre-cessation trigger? Are there other changes that should be made to the Asset Replacement Percentage trigger? Note that this trigger relates to a mismatch between the securities and the Securitization assets that results from changes in the assets. A mismatch may also arise from a change in the securities due to a trigger event under these fallback provisions. Any concerns with the latter scenario can be addressed in responses to Question 16.*

Response: As previously noted, BMO CM believes controls may be necessary to avoid parties taking advantage of such discretion. Controls could include limiting the Designated Transaction Representative to assigning the Benchmark Discontinuance Event and/or Benchmark Replacement Date to certain contractually relevant dates (e.g. settlement/payment date, calculation/ determination date) within a window (e.g. 60 days) prior to the technical Benchmark Discontinuance Event/Benchmark Replacement Date.

Question 3(e): If pre-cessation triggers are not included, are there options available to market participants to manage the potential risks involved in continuing to reference a Benchmark in the circumstances contemplated by each of these pre-cessation triggers?

Response: BMO CM has concerns regarding potential risks that stem from continuing to use LIBOR to determine the interest rate on securitizations. Specifically, a mismatch in benchmarks between the underlying assets and SPE liabilities could be very disruptive. BMO CM, however, does not see a viable option for managing the potential risks outside of the proposed pre-cessation triggers.

Question 4: Should the proposed securitization fallback language permit the Designated Transaction Representative to transition the securities after a trigger has occurred but before the Benchmark Replacement Date? Should any limitations be placed on its use? Should there be a limited date range (e.g., 60 days) prior to the Benchmark Replacement Date in which this could be used? Should the Designated Transaction Representative be limited in the circumstances under which it could elect to utilize the additional time? If so, what standard should be utilized to assess whether the additional time is necessary? In each case, please explain why.

Response: As previously stated, BMO CM believes controls may be necessary to avoid parties taking advantage of such discretion. Controls could include limiting the Designated Transaction Representative to assigning the Benchmark Discontinuance Event and/or Benchmark Replacement Date to certain contractually relevant dates (e.g. settlement/payment date, calculation/ determination date) within a window (e.g. 60 days) prior to the technical Benchmark Discontinuance Event/Benchmark Replacement Date.

Question 5(a): If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for the securities referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR? Please explain why.

Response: The following response applies to questions 5(a), 5(b), 5(c), and 5(d).

BMO CM has the following comments:

1) Term SOFR benchmark is consistent with the majority of BMO CM's current LIBOR-based securitizations transactions. It is unclear, however, whether a forward-looking term benchmark is, objectively, the best rate to use or will be available and robust.
2) The best rate to use as the #1 priority default is the one used by most other instruments.
3) BMO CM is of the view that an interpolated rate is acceptable, but the fallback language should also dictate a priority interpolation method. The Designated Transaction Representative ("DTR") should be responsible for the interpolation. The DTR should be the deal agent, likely a lender in a warehouse deal or the syndicate lead in a term deal.
4) Fallback language should dictate that Benchmark Rate will be re-assessed periodically and reset to the highest priority option available at such assessment date. Securitization deals that are hedged should incorporate fallback language that reflects the waterfall used by the hedging instrument.

Question 5(b): Is there a specific reason that the securitization market should first fall back to forward-looking term SOFR instead of another rate? Please explain why.

Response: See response in question 5(a) above.

***Question 5(c): Is the use of an Interpolated Period appropriate in the securitization markets? Please explain any limitations that should be applied to the use of an Interpolated Period**.*

Response: See response in question 5(a) above.

Question 5(d): In the event a Replacement Benchmark is determined other than under Step 1 of the waterfall, should the waterfall provide that the Replacement Benchmark be changed in the future as soon as a rate can be established under Step 1 of the waterfall?

Response: See response in question 5(a) above.

Question 6(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?

Response: BMO CM is of the view that Compounded SOFR should be the second step in the waterfall. BMO CM further believes a lockout period, in advance of the payment date, may be an appropriate operational feature to allow transaction parties to obtain payment amount prior to the day it is due.

Lastly, there should be a published universal definition/methodology for calculating Compound SOFR. To illustrate why this is important, imagine an instrument with the following returns:

		$100	r + 1
1	10%	$110.0	1.10
2	5%	$115.5	1.05
3	15%	$132.8	1.15

simple mean	10.000%	
geo. mean	9.924%	(1.10 x 1.05 x 1.15)^(1/3)-1

The simple mean would be 10% and the correct geometric mean, calculated as above, yields 9.924%. Note that if you only calculated the geometric mean on the nominal returns and not (1+r)-1, you would get a value of 9.09%, which does not reflect the actual return over the period.

Question 6(b): If you believe that Compounded SOFR should be included, which compounding period is preferable ("in arrears" or "in advance")? Please explain why. Would this preference be influenced by whether ISDA implements fallbacks referencing Compounded SOFR "in arrears" or "in advance?" Please explain whether your preference is based on operational concerns in implementing a particular approach or on economic concerns.

Response: BMO CM is of the view that the most preferable compounding period is "in arrears" because it would most accurately reflect the rate during the interest accrual period as it would retroactively take into account actual overnight SOFR rates during the interest period in question.

Question 6(c): If it was necessary to calculate Compounded SOFR and a third party was not available to perform those calculations, are there parties to the Securitization transactions with sufficient resources to perform those calculations accurately and efficiently? Are there other considerations relating to the calculation of Compound SOFR that would make it an undesirable Replacement Benchmark without the availability of a third party provider?

Response: BMO CM has the following comments:

1) A universal, independent third party provider should be the source. In the event that a third party provider is not available, however, any party acting as Deal Agent, Trustee, Custodian, Calculation Agent, or in a similar capacity will have the sophistication and resources to calculate Compounded SOFR. In addition, the Compounded SOFR should be assessed on publicly available information from sources such as Reuters or Bloomberg.
2) Lack of a third party provider to calculate Compounded SOFR does not alter its acceptability as a Replacement Benchmark Rate, nor does it impact the waterfall position it should hold.

Question 7: As noted, this consultation does not include Spot SOFR as a third step in the waterfall. Do you believe that Spot SOFR is an appropriate fallback reference rate for Securitization contracts or should the second step in the replacement rate waterfall be Compounded SOFR , after which the

replacement rate would be, first, recommended by the Relevant Governmental Body, second, default to then-current ISDA Definitions, and third, proposed by the Designated Transaction Representative?

Response: BMO CM is of the view that spot SOFR is an inappropriate benchmark for term lending and should not be included in the waterfall. The spot SOFR step is moot because the preceding waterfall options (term and compounded SOFR) would seemingly be available if spot SOFR was available and if they were unavailable, spot SOFR should also be unavailable.

Question 8: 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? Please explain why.

Response: A replacement rate determined by the Relevant Governmental Body would be appropriate at this level of the waterfall if there is no SOFR-based fallback rate. A fallback determined by a governmental body would avoid opportunism, or the appearance of such, that could arise from a party involved in the transaction.

Question 9: In the future circumstance where there is no SOFR-based fallback rate and the Relevant Governmental Body has not recommended a replacement rate for Securitizations, is the fallback for SOFR-linked derivatives set forth in the ISDA definitions at the time of cessation the best alternative at this level of the waterfall? Is this fallback appropriate if ISDA Definitions only include overnight fallback rates? Please explain why.

Response: BMO CM is of the view that resorting to ISDA Fallback Rate, even if it only includes overnight rates, is not acceptable. Given the ISDA Consultation, it is unlikely that overnight rates will be the fallback because compounded rates set in arrears are higher in the ISDA priority.

Question 10(a): Since it is unlikely that there will be no ISDA fallback (clause (a) above), this provision is more likely to occur (if at all) when the ISDA fallback is deemed not appropriate for securitization securities (clause (b) above). In that scenario, is this provision appropriate as the final step in the Replacement Benchmark waterfall? Please explain why.

Response: BMO CM is of the view that the practicality and impact of Clause(5) of the proposed Replacement Benchmark definition is unclear and should be deleted.

The most likely scenario would that Clause (5) leads to using the ISDA Fallback Rate, which is the same outcome as Clause (4). Clause (5) resorts to the Interim Benchmark if the Designated Transaction Representative concludes that the otherwise determined Replacement Benchmark is not industry accepted. The Interim Benchmark paragraph (2) states that the Replacement Benchmark shall be the ISDA Fallback Rate. There is a circularity problem here in that either the ISDA Fallback Rate does not exist or was deemed unacceptable by the DTR, but then the definitions end up back at the ISDA Fallback

Rate. Ultimately, BMO CM accepts there will be an ISDA Fallback Rate and that it will be widely accepted by industry participants. Although it may not be the best alternative for securitizations, it would be troubling for an interested party to have the power to unilaterally deem it unacceptable.

Question 10(b)*: *Should the provision allow for "re-testing" the waterfall to determine whether another Replacement Benchmark has become available in the scenario where investors have rejected the Proposed Replacement Benchmark? Should the waterfall be re-tested in any other circumstances (e.g., any time the Replacement Benchmark has been determined under a "less-desirable" clause)? How often? Please explain why.

Response: BMO CM is of the view that the Fallback language should provide for the periodic re-testing of the Benchmark Rate resulting in a reset of the rate to the highest priority option available at such time as the re-assessment is conducted. Re-testing is supported and should be conducted at each contractually defined determination/calculation date, typically monthly. Re-testing should be straightforward so high frequency is not concerning.

Question 11*: *Are there any concerns if a spread adjustment was utilized with cash products that was calculated by a spot rate comparison of the difference between LIBOR and the Replacement Base Rate at the time of conversion? Should this option be included in the spread waterfall? If so, where?

Response: BMO CM has the following comments:

1) A spot spread adjustment determined at the conversion date, while operationally the simplest method, should not be used.
2) ARRC or a similar forum should determine a methodology for calculating an ongoing spread adjustment. That methodology should be applied by the same entity that calculates the Replacement Benchmark Base Rate. The calculated Replacement Benchmark Base Rate and Replacement Benchmark Spread would then be reported by information services such as [a Federal Reserve website], Bloomberg and Reuters.

Question 12: Do you believe that the ARRC should consider recommending a spread adjustment that could apply to cash products, including Securitizations?

Response: BMO CM supports the ARRC recommending a spread adjustment that could apply to securitizations. BMO CM is of the view that an impartial third party is needed to calculate and publish the spread adjustment.

Question 13(a): Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the spread waterfall? Please explain why.

Response: BMO CM is of the view that the spread adjustment applicable to fallbacks for derivatives under the ISDA definitions is appropriate if the replacement rate chosen matches what is recommended by ISDA.

Question 13(b): If the ARRC has recommended a forward-looking term SOFR but has not recommended a corresponding spread adjustment under Step 1 above, do you believe that the ISDA spread adjustment described in Step 2 (which may be intended to apply to a different Replacement Base Rate) should apply to Securitizations? Please explain why.

Response: BMO CM agrees that the ISDA spread adjustment (described in Step 2) should apply to Securitizations, if the ARRC has recommended a forward –looking term SOFR but has not recommended a corresponding spread adjustment (under Step 1), provided the calculation of the spread is using historical mean/median methodology. The critical piece to the calculation is the determination of the appropriate time period for LIBOR/SOFR spread comparison. Utilizing three to five years of data may be sufficient for calculation purposes, however, upon conversion may not be reflective of current spread conditions. The potential for this differential could result in negative consequences for a bond holder

Question 13(c): Given that ISDA has not yet decided upon the spread calculation methodology[16], should Step 2 be excluded from the waterfall? Please explain why.

Response: BMO CM is of the view that it is important to have an established rule book to eliminate any inconsistencies in calculating the replacement spread.

Question 14(a): What type of institution can and should take on the responsibility 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/or (v) elect to cause an early transition under the proviso to the definition of Benchmark Replacement Date?

Response: See response to 13(c) above.

Question 15: Is there any provision in the proposal that would significantly impede Securitization issuances? If so, please provide a specific and detailed explanation.

Response: BMO CM has not identified any provisions in the fallback language proposal that would significantly impede Securitization issuances. BMO CM is of the view the securitization industry is best served by adopting the hardwired approach. The hardwired approach fallback language provides more certainty and consistency in the triggers that signal conversion from LIBOR to a new reference rate, what the Replacement Benchmark will be, and what the Replacement Benchmark Spread will be. This approach will promote an orderly transition from LIBOR to a new reference rate and avoid disruption in Securitization issuances.

BMO CM is of the opinion the decision on which approach to use (hardwired or amendment) boils down to timing. The amendment approach will be the preferred approach for the next 12-15 months because it leaves time to resolve uncertainties about the SOFR regime. After that point, the hardwired approach should be implemented so that negotiations are not being undertaken in the heat of the transition period. Basically, parties should hold off on hardwiring as long as practicable.

Question 16: Given the fallback language for the Securitization and the underlying assets may operate independently, please identify any sources of misalignment between those components that are not addressed in the consultation.

Response: BMO CM believes all relevant issues have been addressed.

Question 17: Are there specific operational challenges that implementing the proposed fallback language might create for securitizations? If so, what are those challenges and under what circumstances might they occur? How might they be mitigated?

Response: BMO CM is of the view that the implementation of the proposed fallback language creates significant operational challenges. The proposed Replacement Benchmarks are calculated differently; as such payments referencing the new rates will differ from those referencing LIBOR. The transition will, therefore, required changes to risk models, valuation tools, product design and hedging strategies.

Question 18: **Please provide any additional feedback on any aspect of the proposal**.

Response: BMO CM does not have any additional comments at this time.