

The Alternative Reference Rate Committee (ARRC)
Federal Reserve Bank of New York
United States of America

February 5, 2019

Credit Suisse Group (Credit Suisse or CS) hereby submits our response to the LIBOR Securitizations consultation paper published by the ARRC on December 7, 2018. We welcome the consultation and believe it to be a vital prerequisite for a market-wide transition to the new alternative reference rates.

In accordance with existing business practice, CS will seek to utilize the fallback standards that are eventually adopted by global securitization/credit industry associations in their respective markets. This letter is intended to highlight our general recommendations for a safe transition to all proposed alternative reference rates, as well as to present a view on topics outlined within the ARRC paper.

CS believes that in principle, an optimal adoption of fallbacks for new Securitization contracts must:

- a. Minimize the potential for market manipulation by any group of market participants, regardless of the timing of the trigger event.
- b. Minimize interpretation risk, by using transparent data and simple and deterministic terms. This should allow all parties to independently derive the fallback terms without the need for additional validation.
- c. Be synchronized, or at least compatible, with developing fallbacks in other related markets (e.g. Derivatives, Loans and Floating Rate Notes).
- d. Minimize the possibility of value transfer at the point of transition, or perceived economic harm on parties, so as to reduce risk of litigation and other disputes.
- e. Minimize event risk by limiting impacts from global monetary policy decisions on or around the day of the fallback being triggered.
- f. Be practical to implement across systems, entailing reasonable implementation overhead and complexity.

We think the availability of published forward-looking term rates will be critical to a safe market-wide transition to alternative reference rates (ARRs). Term rates are used in determining interest payments for the vast majority of Securitized product contracts globally today, and are intuitive and transparent to even unsophisticated counterparties. Not only would term rates be a superior solution to the other waterfall steps proposed in the consultation paper, they would also provide for consistency if adopted in coordination with other markets (e.g. Derivatives, Loans). These term rates could be derived from the developing futures markets in respective ARR (e.g. SOFR futures), and ideally should be made available across the range of primary contract currencies (USD, GBP, CHF, EUR and JPY etc.).

While the fallback terms proposed in your paper are specific to the SOFR rate alone, we believe it essential to align such provisions across all the globally identified ARR (i.e. across currencies). This will minimize the disruption of business practices at large houses like CS that often deal with clients across multiple global Credit markets. Standardization of approaches will also serve to minimize cross-currency basis risk, thus saving potential hedging costs. A simplified approach across currencies would also reduce implementation costs and complexity for all parties.

Here are some additional views on the detailed sections within the consultation paper:

General Approach of the Securitization Fallback Provisions (question 1)

Our responses below are specific to CLOs and Agency and Non-Agency Securitized cash instruments (mortgage-backed securities).

The paper rightly identifies that differences in fallback terms for such contracts and those for their underliers will lead to additional operational complexity. For instance, with regards to CLOs, the proposed fallback language differs materially from prevailing market standards in use today and terms for underlying loan obligations are being developed separately. We request industry associations and the ARRC to provide for closer coordination between the Working Groups for these product types.

Triggers (questions 2 through 3(e))

We support the concept of the in 30 day period to transition in advance of the cessation date in theory. It could provide flexibility and reduce operational risk by allowing for a phased transition as opposed to having to transition several contracts at once. This is akin to the 'early opt in' trigger being proposed by the ARRC for loan contracts. However, we recommend that market standards be developed where such rights of the Designated Transaction Representative (DTR) are well acknowledged market wide. CS stands ready to adopt such a clause, in as much as it is carefully deliberated in industry associations.

We believe the inclusion of pre-cessation clause 5 is helpful, as its determination is made by a regulatory authority, and as such a situation could not give rise to market manipulation or allegations thereof. Our concern with clause 3 is that a failure to publish LIBOR for some days should result in permanent LIBOR discontinuation, not a temporary one, to prevent untimely contractual resets and operational issues. If such a trigger is chosen, we recommend arriving at the 'number of days LIBOR fails to publish' through future industry consultation. Our suggestion for clause 4 is that such a determination would be best made by a regulatory body that the market recognizes, so its definition could be aligned to clause 5.

We note that recent CLO contracts have begun using some form of the 'Asset Replacement Percentage' (clause 6) being proposed which may differ across firms. We think unless such a clause is defined keeping in mind the nuances of each security and underlying asset type, and unless the evaluator and definition of the 'transition threshold' is agreed in market conventions, they could present a disruption from current practices.

In general, any and all pre-cessation triggers should be simple, deterministic and widely known to all market participants. With issuers, trustees, and clients differing in their sophistication and capabilities, disagreements on fallback terms would increase litigation risks. Separately, we are concerned that the recent ISDA consultation for Derivative fallbacks did not propose any pre-cessation trigger events, which would present an apparent departure from ARRC papers for FRNs, Securitizations and Loans.

Benchmark Replacement Date (question 4)

We defer to industry associations to provide a more representative view of participant preferences.

Replacement Benchmark (questions 5(a) through 10(b))

Particularly for CLOs, we think hard-wiring specific benchmarks like SOFR-based benchmarks or those used in ISDA conventions does not make sense if the underlying collateral has not moved toward that benchmark. Observations made over an extended period of time where both LIBOR and SOFR-based contracts trade across a representative set of maturities will be required for comfort. Moreover, it is likely that CLO investors at every tranche will want flexibility similar to what prevails in today's market rather than hardwiring a result that can lead to unacceptable economics for investors.

However, if a 'hardwired approach' is chosen by the ARRC as suggested within the paper, below are our recommendations:

CS appreciates the ARRC's exclusion of 'Overnight SOFR + a Spread' as a lower level of the Replacement Benchmark waterfall, given the concerns we and other market participants have shared in prior responses.

As mentioned earlier, CS highly prefers published term rates to any other derivations noted in the waterfall. We think it has been rightly proposed at the top of the waterfall.

In the absence of a published term rate, a 'compounded in advance' rate is preferred over any overnight/spot rate (which we oppose), as it limits exposure to monetary policy developments on or near the day of the fallback event.

The 'compounded in advance' method is operationally the most practical for the securitization industry, and reflects current market practices and client preferences. The selection of a 'compounded in arrears' approach for the securitization market would cause disruption and require strong industry-wide consensus as it would be a significant departure from how contracts are structured today.

In a circumstance where there is no SOFR-based fallback rate, we would prefer that the replacement rate is determined by the Relevant Governmental Body (e.g., an ARRC-like body), over any ISDA-based determinations.

Replacement Benchmark Spread (questions 11 through 13(c))

CS is opposed to using spot rates to calculate a spread at the point of transition, as this is likely to cause disputes. Using spot rates could bring economic consequences for contract parties, based on fallback timing, thereby increasing litigation risk. The Overnight rate observed at the time of fallback may differ materially from that prevalent during coupon payments, particularly in a sharp interest rate hiking or lowering cycle.

We would highly prefer the ARRC (or another regulatory body) calculating and reporting a spread adjustment that could apply to cash products, including securitization contracts (over any ISDA-determined spreads). This will provide for consistency between markets and provide transparency to all participants and reduce litigation risk.

We also think for the securitization industry some degree of flexibility with regards to determining spreads might be helpful, with (a) an approach correlated to actual market volumes/levels as opposed to historical rates, (b) appropriate safeguards to prevent a group of participants from taking advantage and (c) adequate consensus between transaction beneficiaries.

If ISDA-defined adjustments for Derivatives must be used, CS has previously expressed support for the 'Historical Mean/Median Approach'. While not without its own limitations, this approach allows the least scope for market manipulation, uses readily accessible historical data, and is relatively simple to implement in firm systems. However, the Historical Mean/Median Approach as proposed suggests a simple mean or median on a fixed lookback period. CS has suggested an enhancement where more weight could be given to more recent observation periods by applying a time decay function (e.g. exponential weighing). This would ensure that any extreme market events from the distant past would wield only limited influence on current fallback parameters. Similarly any material moves from the recent past would be appropriately emphasized.

Responsibility for Calculations (questions 14(a) and 14(b))

Within the securitization industry, there are agreed roles for deal custodians, agents and managers who make determinations on behalf of market participants. We believe market conventions could be adopted where the role of such managers is expanded to cover the ARRC-outlined calculation responsibilities. For instance in the case of CLOs, a 'CLO Manager' could play a primary role in computing and communicating fallback terms.

We believe that the availability of agreed third-party screens that are readily available to all market participants including issuers, managers, investors and trustees is key to a safe transition.

General feedback (questions 15 through 18)

To minimize operational concerns, a transition point to alternative reference rates must be clearly defined and communicated sufficiently in advance. This would allow for better market-wide cooperation on both new contracts and historical amendments.

Regardless of the approach eventually recommended by the ARRC, we think consistency of adoption across issuers, trusts and investors of all degrees of sophistication to be the most important objective.

Please direct any questions or feedback to Nomita Singh (Managing Director – Head of US Regulatory Affairs) at nomita.singh@credit-suisse.com

Thank you.