ARRC
Alternative Reference Rates Committee | Newsletter

June – July 2020

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 alternative reference rates transition in the U.S. and global markets.

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Top 3 Takeaways

1. **Federal Financial Institutions Examination Council (FFIEC), Financial Stability Board (FSB), Office of the Comptroller of the Currency (OCC), and Securities and Exchange Commission (SEC) increased their focus on the transition away from LIBOR.**
   - The FFIEC released a statement highlighting the risks from LIBOR's expected cessation and encouraging supervised institutions to continue preparing for it.
   - The FSB released a statement on COVID-19's impact on global benchmark reform, and noted that firms should "remove remaining dependencies on LIBOR by the end of 2021."
   - The OCC reported key issues facing the U.S. banking system and the effects of the COVID-19 pandemic on the federal banking industry in its Semiannual Risk Perspective. It noted that the OCC is increasing oversight of the transition away from LIBOR to evaluate bank preparedness.
   - The SEC Office of Compliance Inspections and Examinations (OCIE) identified registrant preparedness for the transition as an examination program priority this year.

2. **The ARRC released conventions related to using SOFR in arrears, both daily simple SOFR and daily SOFR compounded in arrears, in syndicated loans. The conventions follow the ARRC's 2020 Objectives, which identified the publication of recommended conventions and supporting materials for syndicated loans as a priority milestone for the year.**

3. **Regulatory agencies provided further information on relief from issues associated with transitioning off of LIBOR.**
   - The OCC, the Federal Reserve Board, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency adopted a final rule on swap margins. It permits legacy swaps to retain their legacy status without triggering margin exchange requirements if they are amended to replace LIBOR or another discontinued rate.
   - The Consumer Financial Protection Bureau (CFPB) released a Notice of Proposed Rulemaking (NPRM) on the transition. Among other developments, the NPRM proposes to permit creditors for home equity lines of credit and credit card issuers to replace LIBOR with alternative reference rates, if certain conditions are met.

Other ARRC Developments

- The ARRC launched the SOFR Summer Series, a series of webinars to provide information on the transition from U.S. dollar (USD) LIBOR to SOFR. The events are designed to educate the public on the history of LIBOR, the development and strengths SOFR, and SOFR adoption progress.
    - The series kicked off on July 13 with an event that included Bank of England Governor Andrew Bailey (remarks here), New York Fed President John Williams (remarks here), ARRC Chair Tom Wipf, and Sterling Working Group on Risk-Free Reference Rates Chair Tushar Morzaria.
    - Coverage of the event included articles from Bloomberg, Wall Street Journal, Reuters, and MarketWatch, among others.
    - Recordings from previous sessions and information about upcoming panels are here. Registration for those panels is available here.
- The ARRC announced details about its recommended spread adjustments after reviewing responses to its supplemental consultation on spread adjustments. For non-consumer cash products, the ARRC's recommended spread adjustment will match the value of the International Swaps and Derivatives Association's (ISDA) recommended spread adjustment methodology for derivatives. For consumer products, the ARRC will include a 1-year transition period and further consider the most appropriate approach to the issue of methodology versus value. For all cash products, in the event that a pre-cessation event is operative, the ARRC's recommended 5-year historical median spread adjustments will be determined at the same time as ISDA's spread adjustments.
- The ARRC released "Internal Systems and Processes: Transition Aid for SOFR Adoption" to support market participants transitioning to SOFR. The tool builds on previous ARRC publications, such as the User's Guide to SOFR, the Practical Implementation Checklist and the Buy-Side Checklist, to help identify internal systems and processes impacted by the LIBOR transition.
- The ARRC released final recommended contractual fallback language for new USD LIBOR private student loans to minimize risk and market disruption in the event that LIBOR is no longer usable. The ARRC also released conventions for using SOFR in student loans: 30- or 90-day Average SOFR, with a monthly or quarterly reset period, respectively, with rates determined before the interest period, and a margin set by the lender or originator.
- The ARRC updated its previously released recommended contractual fallback language for USD LIBOR denominated syndicated loans. These updates revise the hardwired fallback language to recommend the use of simple daily SOFR in arrears in the second step of the waterfall and include a more permissive early opt-in trigger, which allows parties to switch to an alternative reference rate like SOFR before LIBOR is officially discontinued or determined to be unrepresentative.
- The ARRC filed a swaptions relief letter with the Commodity Futures Trading Commission (CFTC) Division of Swap Dealer and Intermediary Oversight requesting no-action relief associated with upcoming discount rate changes by a derivatives clearing organization and clarification that Credit Support Annex amendments would not trigger the regulatory requirements covered by CFTC letter 19-26.
- The Chair of the ARRC's Accounting and Tax Working Group released a letter to SEC confirming that the SEC does not object to the ARRC's Accounting and Tax Subgroup's conclusions that SOFR reset features do not represent embedded derivatives that require further assessment for bifurcation.
- The ARRC updated Question 8 in its frequently asked questions (FAQs) to reflect recent developments and information about the work of the ARRC, its progress to date, and the overall effort to promote voluntary market adoption of SOFR.

U.S. Developments

- The New York Fed updated its statement of compliance with the International Organization of Securities Commissions (IOSCO) Principles for Financial Benchmarks, which reflect best practices for the administration and production of interest rate benchmarks. The statement noted that all rates administered by the New York Fed, including SOFR, the three SOFR Averages, and the SOFR Index, are in compliance with the IOSCO Principles.
- The CFPB released several other updates in addition to its NPRM, including an updated Consumer Handbook on Adjustable-Rate Mortgages and guidance in the form of FAQs on transition topics.

- The CME Group reported June and Second-Quarter 2020 market statistics, highlighting that SOFR futures average daily volume increased 43% from June 2019.
- David Bowman, Chiara Scotti, and Cindy M. Vojtech of the Federal Reserve Board published a FEDS note that examines how correlated LIBOR has been with available measures of bank funding costs. They found that LIBOR is not more correlated with their measures of bank funding costs than risk-free rates and that balance sheet exposure could potentially be readily swapped to alternative reference rates such as SOFR.

Market Developments

- ISDA released several updates including:
  - A statement from its Board of Directors on the adherence to the forthcoming ISDA Fallback Protocol. The statement noted that ISDA will "soon publish" the Protocol, which aims to facilitate inclusion of new fallbacks in existing noncleared interbank offered rates (IBOR) derivatives contracts.
  - An announcement that ISDA and Linklaters will release new documentation modules on ISDA Create during 2020 to further automate and streamline the negotiation of derivatives agreements. The documentation modules will include the EONIA Bilateral Template Amendment Agreement to enable parties to update references to EONIA in their documentation. Other interest rate reform documents will be added to this module as they become available. The modules will also cover generic amendment agreements to ISDA published documents to allow users to complete amendments, as well as schedules to the 1992 ISDA Master Agreement (Multicurrency – Cross Border), the ISDA 2002 Master Agreement and the 2002 forms of the Master Agreement under French and Irish law.
  - An "Understanding IBOR Benchmarks Fallbacks" factsheet and a video interview with Ann Battle, Head of Benchmark Reform at ISDA.
  - A "What's Next for Derivatives Markets?" video interview with Scott O 'Malia, ISDA Chief Executive Officer
- Bloomberg and ISDA released several updates, including:
  - A factsheet providing an overview of the methodology and implementation of IBOR fallback rate calculations.
  - A webinar providing background on IBOR fallbacks, how and when investors can leverage them, construction methodology and ISDA definitions and licensing to assist the industry plan for implementation.
  - Updates to Bloomberg's IBOR Fallback Rate Adjustments FAQs, after Bloomberg began publishing monthly test data in Excel files and published indicative fallback rates.

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.

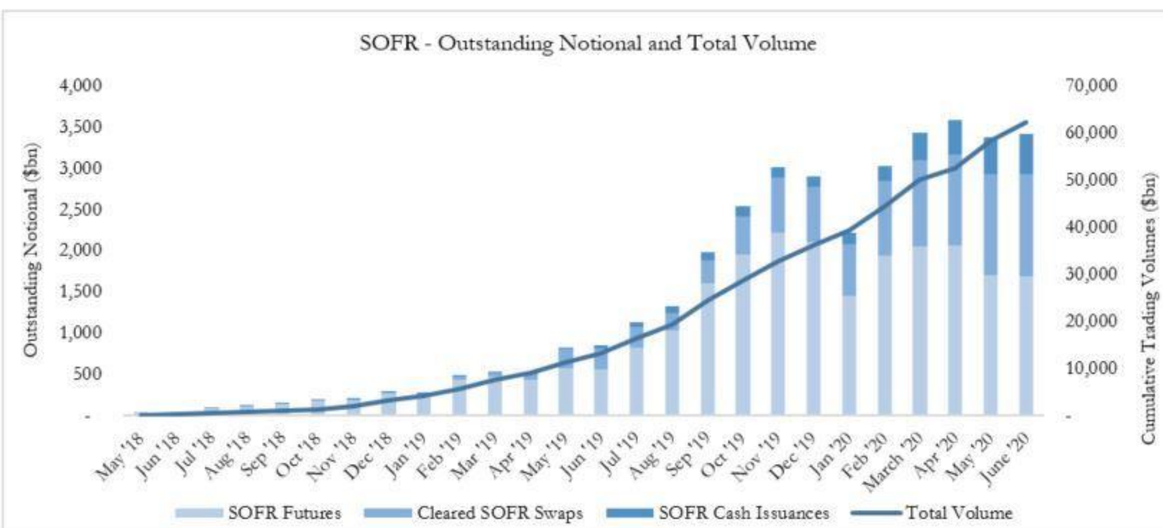
- The FSB and the Basel Committee on Banking Supervision (BCBS) released a report to the G20 on supervisory issues associated with benchmark transition. The report includes insights on remaining challenges to transition based on surveys undertaken by the FSB, the BCBS, and the International Association of Insurance Supervisors. It includes three sets of recommendations to support the transition, related to the identification of transition risks and challenges, facilitation of the transition, and coordination of transition efforts.
- The BCBS published a set of FAQs regarding benchmark rate reform and associated implications under the Basel Framework's definition of capital, market risk, counterparty credit risk, liquidity risk, and operational risk standards.
- The UK Government released a statement describing its intention to legislate to amend the Benchmarks Regulation (BMR) to provide the Financial Conduct Authority (FCA) with regulatory powers to manage and direct any wind-down period prior to eventual LIBOR cessation to protect consumers and ensure market integrity, particularly for 'tough legacy' contracts that cannot transition from LIBOR.

- The FCA [welcomed] the UK Government's announcement to give the FCA enhanced powers and provided information on the proposed legislation.
- ISDA's Scott O 'Malia offered informal comments regarding the UK Government's announcement and what it means for 'tough legacy' LIBOR contracts.

- The FCA also released a follow-up letter to ISDA regarding the 2020 pre-cessation fallback consultation and answering ISDA's questions on how cessation and loss of LIBOR representativeness could interact.
- The FCA's head of markets and wholesale policy Edward Schooling Latter also stated that an announcement on the timing of LIBOR's discontinuation may be made later in 2020. "We know that Libor will continue until end 2021, but announcements about the discontinuation from the end of 2021 of Libor settings could come as early as November or December this year," he said in a webinar. "Market participants need to be ready for that."
- The European Central Bank's Working Group on Euro Risk-Free Rates recommended that counterparties voluntarily exchange compensation for legacy swaption contracts affected by the transition of central counterparty discounting from the euro overnight index average (EONIA) to the euro short-term rate (€STR) targeted for July 27, 2020. The recommendation is based on feedback received from the public consultation that was launched in March.
- The Bank of Japan and Financial Services Agency released a letter to the CEOs of major financial institutions requesting materials to review and monitor the progress of each firm's preparedness for the LIBOR transition. Responses were due July 10, 2020.
- The Prudential Regulation Authority (PRA) published a statement on PRA resolution-related rules regarding contracts in scope of the Contractual Recognition of Bail-In (CROB) and Stay in Resolution (Stays) Parts of the PRA Rulebook. The PRA views that, where the sole purpose of an amendment to a liability or a financial arrangement is to transition away from LIBOR, it should not be considered a material change as the term applies to either the CROB Part or the Stays Part of the PRA Rulebook.

SOFR Market Liquidity

Since SOFR's publication, $670bn notional in floating rate instruments tied to SOFR have been issued, with over $482bn outstanding notional at June month-end.



(As of June 30, 2020; Source: CME Group, LCH, ICE)

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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