



Deloitteⁱ US LIBOR Transition Newsletter

A summary of US regulatory and market updates related to the transition from LIBOR

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Executive Summary

On November 30, 2020, The Federal Reserve System Board of Governors (FRB) and the United Kingdom (UK)'s Financial Conduct Authority (FCA), issued concurrent announcements regarding the potential extension of the publication of certain USD LIBOR settings from December 31, 2021 to June 30, 2023. The FRB statement which was issued jointly with The Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) also encourages banks to cease entering into new contracts that reference USD LIBOR "as soon as practicable" by December 31, 2021 stressing the importance of facilitating an orderly LIBOR transition. The statements intend to allow enough time to address a significant proportion of legacy contracts that reference USD LIBOR as well as provide a clear end date for issuances of new USD LIBOR contracts.

The Intercontinental Exchange (ICE) Benchmark Association (IBA) released a consultation related to the statements issued by the FRB and FCA proposing the extension for USD LIBOR legacy contracts until June 2023 as the current authorized and regulated administrator of LIBOR. This consultation aims at understanding the market participant's views on the proposed extended discontinuation of Overnight, 1-, 3-, 6-, and 12-month LIBOR settings from December 31, 2021 to June 30, 2023 as well as the current, planned discontinuation of EUR, CHF, JPY, and GBP LIBOR tenors and the 1 week and 2 month USD tenors by December 31, 2021. The consultation plans to remain open for feedback until January 25, 2021. Following the UK's initial FCA statement in 2017 starting the LIBOR cessation efforts, the IBA has worked diligently with market participants, panel banks, and the FCA regarding the continuation of certain LIBOR settings beyond 2021.

The FDIC issued a joint statement with FRB and the OCC, reiterating their stance on not making a recommendation for a specific replacement rate for LIBOR-linked loans. Banks may replace LIBOR with a rate of their choosing; however, it is important for banks to include robust fallbacks which contemplate the discontinuation of the initial reference rate. Although the FDIC acknowledges the fact that the Alternative Reference Rates Committee (ARRC) is recommending the Secured Overnight Financing Rate (SOFR) as LIBOR's replacement for cash and derivative products, it is important for banks to address credit-sensitivity, funding cost, and client concerns when selecting a LIBOR replacement rate.

The ARRC also issued a memorandum to the FDIC, the FRB and the OCC summarizing the initial findings and recommendations related to regulatory considerations associated with capital and liquidity requirements for transitioning financial contracts to SOFR. The memorandum highlights the fact that a key policy goal in the transition away from LIBOR is to reduce overall risk to the financial systems. Capital and liquidity considerations, which may adversely impact market participants' eagerness to transition away from LIBOR, are encouraged to be explicitly investigated. Regulators and industry participants are encouraged to come together to develop a response which can avoid unwanted outcomes. The memorandum plans to be iteratively updated as new capital and liquidity considerations are identified.

Key Upcoming Dates

- **January 25, 2021** – ISDA's expected effective date of the IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol.



Our Perspective

The Potential Extension of Certain Legacy USD LIBOR Settings

The FRB and FCA's announcements and the subsequent release of the consultation by IBA came as a welcomed clarification on the anticipated date of the cessation of LIBOR. Although the FRB and FCA announcements on November 30, 2020 don't constitute a trigger event, if the IBA consultation recommends extending timelines and the FCA agrees, a potential trigger event can be possible which may lock in the SOFR and LIBOR spread. This consultation provides the respondents the opportunity to voice their views and provides clear timelines they should align aspects of their LIBOR transition programs with related to contract repapering, communication strategies and technology. IBA's proposed consultation together with the welcoming remarks by the FRB and the FCA can encourage banks to keep moving full speed ahead to facilitate LIBOR transition. We encourage market participants to be prepared for potential, regulatory inquiries to assess their compliance with regulatory expectations. Deloitte recently released a publication on the industry's reactions and possible implications related to the possible extension of certain USD legacy LIBOR contracts and the view towards issuance of new USD LIBOR contracts which can be found [here](#).

FDIC Statement on Reference Rates for Loans

The announcement from the FDIC, the FRB, and the OCC to not recommend a specific replacement rate for LIBOR-linked loans further reinforces that the LIBOR transition is driven by the market and various alternative rates should be considered. With the ARRC recommending SOFR and the Credit Sensitivity Group exploring a credit sensitive rate, there are still regulatory, industry and market participants working on identifying alternatives from various angles. Market participants are encouraged to continue to evaluate which alternative reference rates fits their particular business needs for the range of products which plan be available in the market.

ARRC's Capital and Liquidity Regulatory Considerations for the LIBOR Transition

The ARRC's memorandum provides market participants clarity related to some of the ambiguities surrounding regulatory capital implications of the LIBOR Transition. The memorandum highlights the impact on Fundamental Review of the Trading Book (FRTB), Internal Model Method (IMM), Internal Models Approach (IMA), Comprehensive Capital Analysis and Review (CCAR) are some of the various regulatory considerations firms should begin to assess and evaluate. Treasury, Market Risk, Credit Risk and Regulatory Capital groups should especially be engaged to evaluate model change needs, system testing requirements, and prepare for potential regulatory review for the various regulatory requirements the memorandum outlines.



Regulatory Updates

Summary of ARRC Office Hours Q&A with David Bowman (FRB)

This section represents a summary of the ARRC office hours Q&A with David Bowman from November 1, 2020 until November 30, 2020. Weekly office hour information can be found [here](#). The information below does not represent the view of the Federal Reserve but represents the personal views of David Bowman outside of his official capacity. Below are some of the specific topics discussed:

Deviations from the Safe Harbor Provisions

- The United States Treasury plans to provide interim relief through a “Safe Harbor” if market participants apply the ARRC recommended fallback language as of a specific date. The ARRC, however, has not mentioned any modifications to the proposed fallback language, and therefore such modifications may not be covered by the Safe Harbor provisions. It is important to note that hardwired fallback language may be treated differently than a negotiation which may be considered a modification of the contract. It is possible that adding to or modifying fallback language could be considered a non-taxable event, however market participants should consult with tax attorneys for confirmation.

Chicago Mercantile Exchange (CME) and London Clearing House (LCH) Big Bang Approach

- On October 16 to October 19, 2020 the LCH and CME moved their discounting (all legacy and new cleared derivative products) from effective federal funds rate (EFFR) to SOFR. The transition was smooth, and both clearing houses now discount and pay interest based on SOFR. Temporary relief was provided to both houses regarding reporting, a key step in the Paced Transition Plan, and was successful in its intent to increase SOFR liquidity.

Term SOFR Rate

- There has been no confirmation of when market participants can expect a term SOFR rate to date. The ARRC is currently reviewing responses to their request for proposal (RFP) for a provider to supply term SOFR rates. The term rate recommendation by the ARRC depends on the following criteria: 1) the reason for the recommendation, 2) robustness of the chosen rate, and 3) how compelling the chosen rate is based on the futures and swaps transaction. Assuming the short term SOFR market continues to grow, this process may extend well into next year.

ISDA Fallbacks for Stub Periods

- If an entity were using 1-month LIBOR rate for the 10 days of stub period, the calculation rate may have to switch to 1-month compounded average of SOFR in arrears plus a spread adjustment since ISDA fallbacks are tied to LIBOR. Stub refers to a modification to the swap trade, where the contract matures within certain days at the start of the month and does not last the whole month.

Flexibility in ARRC Recommended Fallback Language for Bilateral Loans with Hedged Swaps

- Hedge accounting rules need not require a perfect hedge and may allow for some basis as long as the most effective hedge is selected for cashflow and liquidity management. ARRC has two sets of fallback languages related to bilateral loans with hedged swaps: 1) Based off the ARRC recommended conventions for syndicated loans, the ARRC recommends using a lookback with a payment delay or shift, acknowledging this does not account for a perfect hedge. However, to match the derivative’s fallback to the loan’s fallback, an entity could bilaterally negotiate the derivative and implement their own fallback language. ISDA offers tools to allow for bilateral negotiations on derivatives. Alternatively, an entity could close out the LIBOR loan, establish a SOFR loan, and then choose the appropriate hedging options, and, 2) One could also use the Hedged Language Approach whereby an entity would use the same fallbacks ISDA would implement for derivatives. Using this method, the loan would fall back to the same version of compound average SOFR the derivative would fallback to.

Residential Non-Conforming Mortgage Loans

- ARRC has not set a timetable for lenders providing notice of rate change for consumer borrowers related to residential non-conforming mortgage loans. The ARRC generally recommends a 6-month notice period to name a new rate provided by the issuer of the bonds to the investors but hasn’t made recommendations for consumer products as they are required to adhere to regulations that vary in each state.

Addressing Non-USD LIBOR Contracts Under NY Law

- A few potential solutions could address non-USD LIBOR Contracts written under NY Law, including buy backs or exchanges with alternative fallbacks. It looks as though the UK is moving towards a synthetic Sterling LIBOR, however this transition may pose litigation risk if written under NY law.

Interest Period Weighted Shift vs. Observational Period Shift

- For a loan, it is important to apply interest to the number of days interest is outstanding because it can be paid down at any time. For a longer instrument like floating rate debt, observational period shift is more of a preference, but it makes more sense to pay a fix amount per month instead of per day in the period.

Regulatory Highlights

- On November 30, 2020, the FRB and the UK's FCA issued concurrent announcements regarding the potential extension of the publication of certain USD LIBOR settings from December 31, 2021 to June 30, 2023. The FRB statement is available [here](#) and the FCA statement is available [here](#).
- IBA published a consultation regarding their plans to extend the publication of certain LIBOR settings from December 31, 2021 to June 30, 2023. The consultation is available [here](#).
- The FDIC issued a joint statement with the FRB and the OCC, reiterating their stance on not making a recommendation for a specific replacement rate for LIBOR-linked loans. The statement is available [here](#).
- The ARRC issued a Capital and Liquidity Regulatory memorandum on the preliminary findings and recommendations regarding potential regulatory considerations of the LIBOR transition. The memorandum is available [here](#).

ARRC Working Group

- The FRB issued a press release on IBA's proposed path for the transition away from USD LIBOR. The press release is available [here](#).
- The ARRC applauded major milestone in transition from USD LIBOR. The press release is available [here](#).
- The ARRC published conventions for using SOFR in arrears in bilateral business loans. The press release is available [here](#) and the conventions are available [here](#).
- The Credit Sensitivity Group (CSG) will hold additional sessions. Working session schedules are available [here](#).

ISDA Updates

- ISDA issued a statement on "IBA and UK FCA Announcements on LIBOR Consultations". The statement is available [here](#).
- ISDA has added Robotic Integrated Support (IRIS) to both the ISDA protocols and ISDA benchmarks pages. The updated ISDA protocol page is available [here](#) and the ISDA benchmarks page is available [here](#).
- ISDA published the "ISDA Swaps Info Third Quarter of 2020 and Year-to-September 30, 2020" review report. The report is available [here](#).
- ISDA published the "October 2020 ISDA RFR Adoption Indicator" report. The report is available [here](#).
- ISDA issued a guidance on the "Refinitiv announcement of permanent cessation of 6-month and 12-month CDOR tenors". The press release is available [here](#).
- ISDA aired a monthly podcast for LIBOR transition. All episodes of the podcast are available [here](#).

Other News/ Useful Reading

- CME Group will begin publishing Sterling Overnight Index Average (SONIA) and Euro Short-Term Rate (€STR)-based MAC Rates in December 2020. The statement is available [here](#).
- CME published their November rates recap report. The report is available [here](#).
- ICE published their October Interest rates report. The newsletter is available [here](#).
- CME published their SOFR futures trade data. The article and data are available [here](#).
- SOFR: Critical financial transition shrouded in ambiguity. The article is available [here](#).
- "Surge in SOFR Derivatives Bodes Well for Shift". The article is available [here](#).
- "LIBOR transition could be Y2K Groundhog Day for regional banks". The article is available [here](#).
- "LIBOR Bill to Ensure Replacement Rate Introduced in N.Y. Senate". The article is available [here](#).
- "Will 2021 be the year that LIBOR loans take the leap?" Article available [here](#).
- "LIBOR: ISDA fallback protocol is no miracle solution". The article is available [here](#).
- "Agencies Reiterate That Banks May Use 'Appropriate' Non-SOFR LIBOR Alternatives". The article is available [here](#).
- "First electronic SOFR vs EFR swap compression trade executed on Bloomberg's swap execution facility (BSEF)". The article is available [here](#).
- "Congress readies surprise 'tough legacy' LIBOR fix". The article is available [here](#).
- "SOFR trading tails off after CCPs 'big bang' boost". The article is available [here](#).



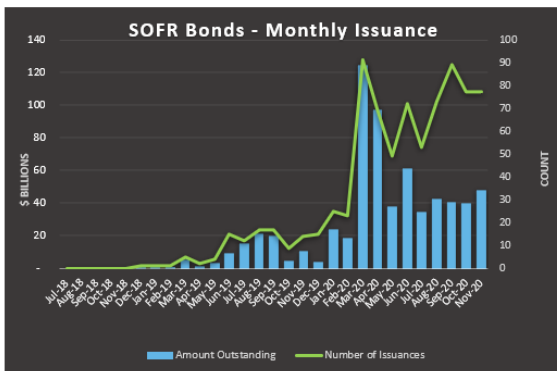
Market Updates

Increase in Debt Issuance Referenced to SOFR

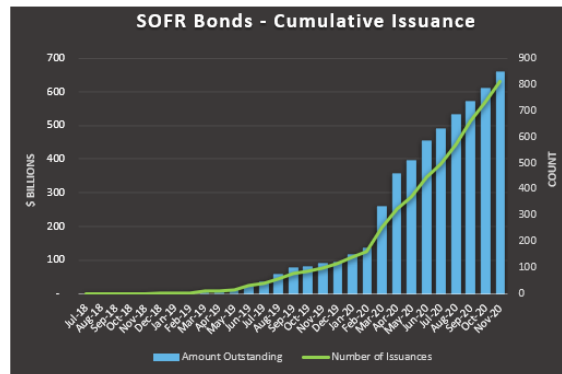
The issuance size of SOFR referenced debt increased in November 2020 compared to the issuances in October 2020. The issuance was \$47.34 billion in November 2020 which increased from \$38 billion in October 2020. The graphs below represent data through November 30, 2020.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently \$684.15 billion with 851 bonds through December 160, 2020. There were 77 new issuances in November 2020 and October 2020 and 93 issuances in September 2020.

In November 2020, federal agencies issued 43 SOFR referenced Floating Rate Notes (FRNs) worth \$27.82 billion. There were 27 other institutions which contributed \$19.51 billion to the outstanding amount of SOFR referenced debt.



Source: Bloomberg, compiled by Deloitte
Data as of Nov. 30, 2020

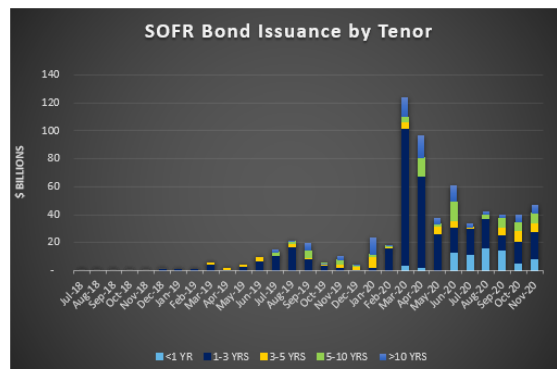


Source: Bloomberg, compiled by Deloitte
Data as of Nov. 30, 2020

Decrease in Longer Dated Debt Issuance (maturity >= 5 years) Referenced to SOFR

SOFR debt issuances with a maturity greater than or equal to five years decreased in November 2020 compared to October 2020. During November 2020, there were 4 bonds issued which have a maturity between five and ten years. The issuances during November 2020 includes 22 bonds with an amount outstanding of \$6.38 billion which have a maturity greater than or equal to ten years, which has increased as compared to \$5.22 billion in October 2020.

There were 28177 issuances of SOFR bonds outstanding worth \$180.561.4 billion, with a maturity greater than or equal to five years, through December 160, 2020 including 2240 issuances worth \$12491.38 billion with a term greater than or equal to 10 years.

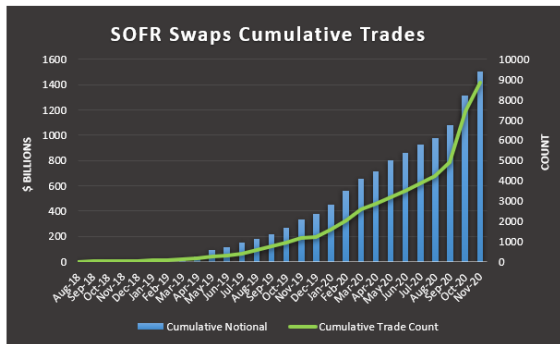


Source: Bloomberg, compiled by Deloitte
Data as of Nov. 30, 2020

Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

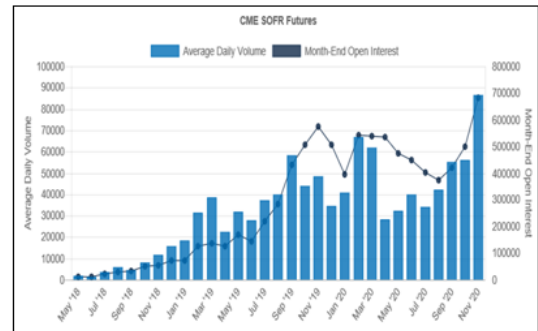
- The cumulative traded notional for SOFR based interest rate and basis swaps totaled \$1500 billion through November 30, 2020.
- For the month of November 2020, the notional volume of SOFR-based interest rate and basis swaps totaled \$190.4 billion compared to the \$231.2 billion in October 2020, and \$100 billion in September 2020.



Source: <http://swapsinfo.org/>, compiled by Deloitte
*Data as of Nov 27, 2020

SOFR Futures

- As per the data available on CME, for November 2020, SOFR futures average daily volume reached 87K contracts/ day. The data is available [here](#).
- The month-end open interest for SOFR futures as of November 2020 was around ~681K contracts. The data is available [here](#).



Source: CME Group
*Data as of Nov 30, 2020

Global IBOR Activity

The market activity in Sterling Overnight Index Average (SONIA), Swiss Average Rate Overnight (SARON) and Euro Short-Term Rate (€STR) based debt issuances and swaps have continued to increase. The table below represents the cumulative bond issuances (does not exclude matured bonds) and the cumulative notional of swaps outstanding through November 30, 2020.

Alternative Reference Rate	Swaps Cumulative notional amount (US \$ Billions)	Bonds Cumulative issuance amount (US \$ Billions)
SONIA	31,587	94.5
SARON	59	NA
TONA	584.2	NA
€STR	73.8	4.2

Source: Bloomberg, <http://swapsinfo.org/>, compiled by Deloitte
Data as of November 30, 2020



Global Highlights

United Kingdom

- The FCA issued a response to IBA's proposed consultation on intention to cease USD LIBOR. The article is available [here](#).
- UK Government issued a statement and amendments to the benchmarks regulation to support LIBOR transition bill for the orderly wind-down of LIBOR. The statement and the amendment is available [here](#).
- "UK to Tweak Tax Guidance for Withdrawal of LIBOR Benchmark". The article is available [here](#).
- "The end of LIBOR in the UK loans market – achieving the end Q1 2021 milestone". The webinar is available [here](#).
- The FCA responded to the treasury announcement on equivalence. The article is available [here](#).
- "UK government announces equivalence between UK and EU benchmark regulations". The article is available [here](#).
- FCA issued a consultation on designation of benchmarks under new Article 23A. The consultation is available [here](#).
- The FCA issued a consultation on the exercise of the FCA's powers under new Article 23D. The consultation is available [here](#).

European Union

- The European Central Bank (ECB) issued a public consultation on EURIBOR fallback trigger events. The consultation is available [here](#).
- The ECB issued a statement on the ISDA 2020 IBOR Fallbacks Protocol and IBOR Fallbacks Supplement. The statement is available [here](#).
- "Euribor rates hit record lows". The article is available [here](#).
- "EU LIBOR tough legacy fix creates some litigation risk". The article is available [here](#).

Asia

- The Hong Kong Monetary Authority (HKMA) notified that tenders were invited for implementation services for LIBOR transition project in Calypso system. The notification available [here](#).
- "HKMA Invites Tenders to Implement LIBOR transition for exchange fund". The article is available [here](#).
- "The Stock Exchange of Hong Kong Limited (HKEX) to clear SOFR cross-currency swaps from early 2021". The article is available [here](#).
- "Transition to SORA: Key Timelines to Cease Issuance of SOR-Linked Financial Products & Market Guidance". The article is available [here](#).
- The Association of Banks of Singapore (ABS) updated the SORA transition roadmap. The updated roadmap is available [here](#).
- The ABS hosted a webinar on SOR Transition to SORA. The webinar is available [here](#).
- The Oversea-Chinese Banking Corporation (OCBC) issued the first SORA-linked green loan. The press release is available [here](#).

Australia

- "Regulators urge Australian institutions to adhere to the ISDA IBOR Fallbacks Protocol and Supplement". The article is available [here](#).
- The Australian Securities and Investments Commission (ASIC) published an information sheet on managing conduct risk during LIBOR transition. The guidance is available [here](#).

Contact Us

For further details on how we can help firms experience an effective transition away from LIBOR, please visit our website:

[DELOITTE LIBOR TRANSITION WEBSITE](#)

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