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Deloitte LIBOR Transition Newsletter
March 2021
Regulatory Updates: 02.01.21 – 03.05.21
Market Updates: 02.01.21 – 3.10.21

Deloitte[i] US LIBOR Transition Newsletter

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

Executive Summary

On February 10, 2021, the Office of the Comptroller of the Currency (OCC), issued a self-assessment tool for banks to evaluate their preparedness for the expected cessation of LIBOR. Subsequently, on March 9, 2021, the Federal Reserve Board (FRB) issued guidance (SR 21-7) for examiners to review the progress of supervised firms in preparing for the LIBOR transition during examinations and other supervisory activities in 2021. The scope of examination will be determined based on the size and complexity of the LIBOR exposures, with increased supervisory scrutiny at larger firms (consolidated assets greater than $100 billion) with significant LIBOR exposures. The guidance states, “Supervised firms that are not making adequate progress in transitioning away from LIBOR could create safety and soundness risk for themselves and for the financial system.” Examiners will be expected to issue supervisory findings and other supervisory actions for firms that are not prepared to cease LIBOR-based contract issuance by December 31, 2021.

The UK’s FCA and the Intercontinental Exchange (ICE), the regulator and administrator of LIBOR, have confirmed the dates when all LIBOR settings plan to either cease to be provided by any administrator or may no longer be representative. This is the case immediately after December 31, 2021 for all Sterling, Euro, Swiss Franc, and Japanese Yen settings, as well as the 1-week and 2-month US Dollar settings. The remaining US Dollar settings plans to continue to be published until June 30, 2023. This announcement triggered the pre-cessation trigger and the spread adjustments were fixed for the ISDA IBOR Protocol, clearing the path for the transition away from LIBOR.

A major milestone in the transition away from LIBOR was reached as International Swaps and Derivatives Association's (ISDA's) new fallbacks went into effect on January 25, 2021. At that time, more than 12,000 entities across 80 jurisdictions had adhered to the ISDA protocol which incorporates the new fallbacks into existing derivatives contracts linked to LIBOR and other key interbank offered rates (IBORs). The protocol adherence window is still open, and the number of adhering entities is still climbing every day. The UK's Financial Conduct Authority (FCA) has estimated that over 85% of non-cleared interest rate derivatives in the UK which reference sterling LIBOR now include fallbacks addressing the permanent cessation of LIBOR as a result of relevant parties all having adhered to the protocol. This number is expected to climb to 97%, with bilateral negotiations (for which ISDA has provided industry amendment templates) covering the outstanding population of non-cleared interest rate derivatives.

While the ISDA protocol implemented the new ISDA IBOR fallbacks into existing agreements, the IBOR Fallback Supplement #70 to the 2006 ISDA Definitions covers new trades entered into on or after the effective date of January 25, 2021 for GBP LIBOR, CHF LIBOR, USD LIBOR, EUR LIBOR, EURIBOR, JPY LIBOR, and other key benchmark rates. In line with the ISDA protocol fallbacks, the supplement includes a "waterfall" approach with associated trigger events to be used if the specified fallback rate (i.e., Secured Overnight Funding Rate (SOFR) in the case of USD LIBOR) were also to cease being produced, either temporarily or permanently. Agreements that do not incorporate the 2006 ISDA Definitions may require a different method to include the new ISDA IBOR fallbacks. Supplement #70 to the 2006 Definitions was quickly followed by Supplement #71, which specifically addresses AMERIBOR.

Key Upcoming Dates

- **March 31, 2021** – Vote scheduled for NYS budget bill, which includes Governor Cuomo's proposed legislation to allow contracts to replace LIBOR with a rate recommended by the Federal Reserve Board (FRB) or the Alternative Reference Rates Committee (ARRC).

Our Perspective

Assessment of LIBOR Transition Plans: FRB SR 21-7

The OCC checklist and FRB announcement are strong signals from regulators that the LIBOR transition continues to be a high priority for them in 2021. It is clear from these communications that there is a significant expectation that supervised firms have made meaningful progress in their LIBOR transitions and continue to prioritize this work. For organizations that have not yet begun, or achieved substantial progress in, their LIBOR transitions, now is the time to accelerate the transition efforts. LIBOR transitions have been a multi-month/year and time-consuming effort for peers in the industry. If organizations are to meet the December 31, 2021 deadline, a thorough plan should be established and executed. For organizations that have achieved meaningful progress and are on track to meet the December 31, 2021 timeline, now is a good time to begin the regulatory review readiness assessment activities. Organizations should determine if sufficient documentation has been prepared for supervisory review to demonstrate the wide range of considerations made, actions taken, and involvement from senior leadership. It may be beneficial to have "fresh eyes" review the work that has been performed to-date to identify if there is any aspect of the LIBOR transition that has been overlooked or not fully addressed.

FCA and ICE Transition Timeline

The announcements from the FCA and ICE mark a crucial milestone in the transition away from LIBOR, specifically achieving a major goal of the planned transition: reducing uncertainty in the timing of LIBOR's cessation. The specific dates mentioned in the announcement, along with their impact on the ISDA protocol, now set out a clear path for LIBOR's end-date. New LIBOR linked trades are not expected to be issued beyond the outlined dates, and market participants have ample time to address legacy contracts. As phrased by FCA CEO Nikhil Rathi, "[These] announcements provide certainty on when the LIBOR panels will end. […] Market participants must now complete their transition plans." Firms should begin reassessing their contract population to identify those contracts expiring before 2023 which will take less priority based on this announcement. They should also begin to coordinate with their systems teams and confirm that the spread can be adopted and take into account product-specific requirements such as the one-year spread transition period for consumer products.

ISDA IBOR Fallbacks Milestone

Although the implementation of the new ISDA fallbacks is a major achievement, market participants still have a lot of work to do. Fallbacks are an important one-size-fits-all safety net to promote a viable back-up rate to be available once an IBOR ceases to exist. However, regulators have emphasized that market participants may be able to achieve even more desirable outcomes by bilaterally negotiating their agreements prior to the cessation date. Outstanding tough legacy exposures where it is not possible to make contractual amendments are also important to consider. Although legislative solutions are being contemplated, it is important that these solutions are consistent across products and jurisdictions. Market participants should not rely upon potential legislative language to address contract risks.

ISDA Supplements to the 2006 Definitions

As opposed to the ISDA protocol which seeks to address future uncertainty in existing derivative trades, the ISDA Supplements to the 2006 definitions address this risk for future trades themselves which is important in achieving a consistent fallback approach for both legacy and new trades to minimize operational difficulties. The joint effective date for both the Protocol and Fallback supplements (assuming other LIBOR currencies and jurisdiction follow the UK's progress to date with regards to protocol coverage) can significantly mitigate the risk associated with a large portion of the estimated $260 trillion in outstanding LIBOR-linked contracts, as well as future LIBOR-linked contracts. Firms should consider reviewing the supplement and understand the population of fallbacks impacted and potential implications across systems, front office, models, treasury, and other areas to ensure these new trades can be captured and incorporated into the firm's portfolio.

Regulatory Updates

Summary of ARRC Office Hours Q&A with David Bowman of the Federal Reserve Board (FRB)
This section represents a summary of the ARRC office hours Q&A with David Bowman from February 1, 2021 until February 28, 2021. Weekly office hour information can be found **here**. The information below does not represent the view of the FRB but represents the personal views of David Bowman outside of his official capacity. Below are some of the specific topics discussed:

30 vs. 90-day SOFR for Consumer Products

- 30-day SOFR rates are typically preferred to 90-day SOFR rates for consumer products. One compelling reason, as described in an ARRC white paper, is that basis tends to be reduced when 30-day SOFR rates are used as compared to 90-day SOFR rates.

The UK's Rush to End LIBOR Use

- To speed up the transition away from LIBOR, the Sterling Working Group has suggested a replacement rate choice for loans or, alternatively, a mechanism which would allow lenders/borrowers to move away from LIBOR before the official cessation date. If this mechanism were to be confirmed, specific fallback language would not be needed. The Loan Market Association (LMA - a Sterling Working Group member) has published fallback language in the past, and although not deemed "official", is widely accepted.

Publication of a Forward-looking Term Rate

- The ARRC continues to interview potential benchmark administrators and are currently evaluating proposals. The ARRC has yet to determine the appropriate scope of use and metrics used to decide when or whether a term rate will be recommended. It is unlikely to meet the June 2021 goal set in 2020.

Lookback Methodology Over Holidays

- The main purpose of the lookback mechanism is to provide sufficient time to calculate an interest rate. A Friday holiday is a good example case as banks are generally open, but the repo market may be closed. Under the ARRC conventions, one would look back 5 business days from the interest accrual date, skipping any included holidays. The ARRC conventions are simply provided as guideline as market participants can have the ability to define the way lookbacks work in any given contract.

ARRC, Loan Syndications and Trading Associations (LSTA), and ISDA Conventions

- The ARRC, LSTA, and ISDA conventions are typically in line with each other. For example, the ARRC recommends that interest rates be rounded to five decimal points for ledgers (any calculated and reported rate), but not rounded for internal calculations. The ARRC recommendation is a perfect match to the ISDA recommendations on rounding.

Protocol Adherence and LIBOR Swaps After Cessation

- In a post-LIBOR cessation world, prior adherence to the protocol is extremely important as it confirms negotiating parties have agreed to switch to an alternative reference rate, and the contract in question can remain valid. There is no need for a confirmation amendment or notification since adhering to the protocol amends the contract's underlying definitions. If parties have not adhered to the protocol by the LIBOR cessation date, the calculation agent may need to poll a set of banks (likely unsuccessfully) which may result in legal action to determine what amounts need to be paid and received. The dealer may not be able to unilaterally transition to a replacement rate and spread unless the proposed New York State Legislation is passed which would insert SOFR in the contract's fallback language (assuming the contract falls under New York State law).

ARRC Loan Conventions

- The ARRC's SOFR loan conventions did not take same day borrowing into consideration. For same day loans (e.g., Prime Loans or USD Fed Funds Loans) the concept is similar to the daily simple SOFR calculation concept in that one may need to use SOFR published on the same day. For operational reasons if a lookback is required, then the lookback may or may not be a 5-day period based on the loan requirement. Thus, such loans can use SOFR and need not rely on the Prime Rate or other rates.

SOFR Compounding, Margin, and Spread Calculations

- ARRC conventions use compounding to calculate SOFR but do not use compounding for the associated margin and spread. SOFR spread calculations involve a 5-year historical median spread between LIBOR and SOFR of comparable (or equivalent) tenor in arrears. This spread is then treated as additive to the SOFR rate to determine the all-in rate. Therefore there is no need to apply any further compounding to the spread since it has already been added. Margin calculations also do not require compounding for two main reasons: 1) it is operationally easier not to calculate the effect of compounding, and 2) it is easier to understand margin requirements from a 'basis-point' point of view, rather than to understand it by compounding. In theory, there is no reason not to compound the margin, however, there does not seem to be great desire to do so. For example, if one were to hedge a SOFR- Overnight Indexed Swap (OIS) spread, compounded SOFR in arrears would be the floating rate of choice. Compounded SOFR in arrears plus some basis point may fully hedge the floating rate component. If one were to calculate the compounding on the margin, the calculation would be less accurate than if using the spread adjustment to begin with.

ICE SOFR Swap Rate

- As there is now an ICE SONIA swap rate, it is likely that an ICE SOFR swap rate may soon be published. The ICE would, however, require additional dealers to quote rates on these swaps. Other vendors may alternatively also begin publishing SOFR swap rates.

Non-Linear Derivatives and ARRC Next Steps

- The ARRC is currently seeking to publish either a whitepaper or a consultation on non-linear derivatives. It would currently propose the same formula as proposed by the Sterling Working Group. The conversion for USD OIS is different, and hence the formula would differ from the Sterling Working Groups' formula in terms of how the spread adjustment is calculated and how one translates from a quarterly LIBOR Swap to OIS Swap, but should be available in the coming weeks. The ARRC is also engaged with ISDA to offer a tool to assist in the conversion of ICE USD LIBOR Swap rates to a SOFR Swap rates.

Regulatory Highlights

- On March 9, 2021, the FRB issued guidance (SR 21-7) for examiners to review the progress of supervised firms in preparing for the LIBOR transition during examinations and other supervisory activities in 2021. The guidance is available **here**.
- The FCA and ICE have confirmed the dates when all LIBOR settings will either cease to be provided or will no longer be representative. The article is available **here**.
- OCC releases a self-assessment tool for banks to check their LIBOR readiness. The tool is available **here.**
- ISDA's new IBOR transition fallbacks came into effect on January 25, 2021. The article is available **here**.
- The IBOR Fallback Supplement #70 to the 2006 ISDA Definitions covers new trades entered into on or after the effective date of January 25, 2021 for multiple key benchmark rates. The updated definitions are available **here.**

ARRC Working Group

- The ARRC issued a press release on chairman Tom Wipf's statement and article on transitioning to SOFR. The press release is available **here**.
- The ARRC released its conventions for SOFR-based intercompany loans to support non-financial corporations through the LIBOR transition. The press release is available **here** and the conventions are available **here**.
- The ARRC published its December-January newsletter. The newsletter is available **here**.
- The minutes of the Credit Sensitivity Group January meeting on the implementation framework for commercial loan products were published. The meeting minutes are available **here**.
- The ARRC published its agenda from the February 17, 2021 meeting. The agenda is available **here**.

ISDA Updates

- ISDA published an article titled "A big milestone for benchmark reform as ISDA's new IBOR fallbacks became effective". The article is available **here**.
- ISDA published its 2020 IBOR Fallbacks Protocol (IBOR Fallbacks Protocol) FAQs. The FAQs are available **here**.
- ISDA SwapsInfo published the full 2020 and Q4 review. The report is available **here**.
- ISDA published its ISDA-Clarus RFR Adoption Indicator for January 2021. The report is available **here**.
- ISDA updated the definitions in the supplement #71 to the 2006 definitions covers 30 and 90-day AMERIBOR published and effective as of February 22, 2021. Updated definitions available **here**.

Chicago Mercantile Exchange (CME), London Clearinghouse (LCH) & ICE Updates

- On February 16, 2021 LCH released preliminary results of the consultation sent to all SwapClear participants in December 2020 regarding the treatment of outstanding cleared LIBOR contracts at or around an Index Cessation Effective Date and their potential conversion into (or replacement with) corresponding RFR-based contracts. The results are available **here**.
- CME published its February 2021 rates recap. The report is available **here**.
- CME published a report titled "LIBOR fallback proposal for CME Eurodollar futures and options". The report is available **here**.
- ICE published its Interest Rates Report for January 2021. The report is available **here**.
- Risk.net published an article titled "Swaps users shun cash compensation in LCH LIBOR switch". The article is available **here**.

Other News/ Useful Reading

- The NY State Senate bill S9070 is currently under review with the New York State legislature. The status tracking of the bill is available **here**.
- "IHS Markit to publish daily credit spread adjustment for SOFR from Q2 2021". The press release is available **here**.
- "FCA sees 'no case for delay' on LIBOR cessation ruling". The article is available **here**.
- "ISDA fallback protocol sees healthy take-up". The article is available **here**.
- "LIBOR's endgame in U.S. requires urgent preparation". The article is available **here**.
- "Short-term interest rates demand attention". The article is available **here**.
- "The financial world's 'most important number' refuses to die". The article is available **here**.
- "Funds steering clear of bets on LIBOR timeline after losses". The article is available **here**.
- "SOFR swaps traded volume hit new high in January". The article is available **here**.
- "Mutual funds are slow to adopt SOFR". The article is available **here**.
- "LIBOR exit to cost global banks 100 million each this year". The article is available **here**.
- Risk.net released an audiocast titled "Key questions about the LIBOR transition". The audiocast is available **here**.
- "Market updates on the LIBOR transition". The article is available **here**.
- "Update on LIBOR transition efforts in global structured finance. The article is available **here**.
- "More time to prepare for LIBOR's end? Yes and No". The article is available **here**.
- "Wall Street takes fresh steps to kick $200 trillion LIBOR debt habit". The article is available **here**.
- "Campaign to kill off LIBOR is boosted by landmark bond sale". The article is available **here**.
- "Planning for a Successful Transition of Intercompany LIBOR Positions". The article is available **here**.

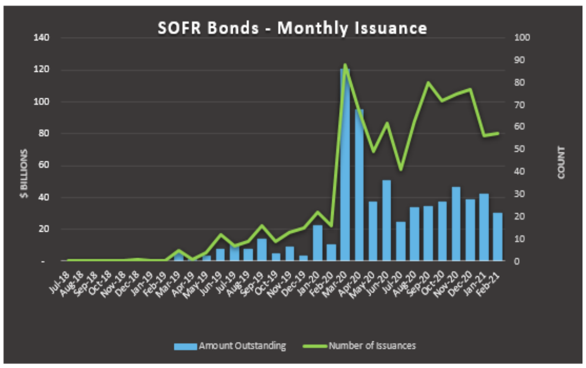
Market Updates

Decrease in Debt Issuance Referenced to SOFR

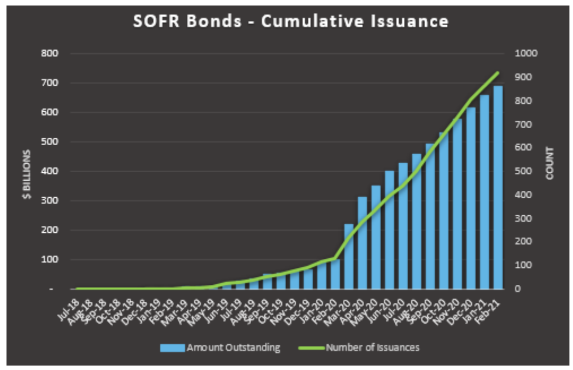
The issuance of SOFR referenced debt decreased in February 2021 compared to issuance in January 2021. The issuance size was $29.92 billion in February 2021, which decreased from $42.33 billion in January 2021. The graphs below represent data through February 28, 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently $689.41 billion with 939 bonds through March 10, 2021. There were 57 new issuances in February 2021 compared to 56 in January 2021 and 77 in December 2020.

In February 2021, federal agencies issued 27 SOFR referenced Floating Rate Notes (FRNs) worth $14.19 billion. There were 30 other institutions which contributed $15.73 billion to the outstanding amount of SOFR referenced debt.



Source: Bloomberg, compiled by Deloitte
Data as of Feb 28, 2021

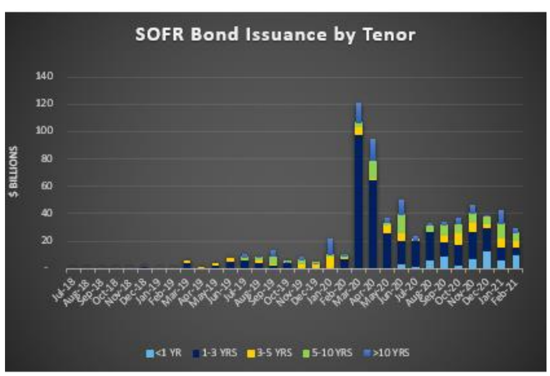


Source: Bloomberg, compiled by Deloitte
Data as of Feb 28, 2021

Decrease in Longer Dated Debt Issuance (maturity >=10 years) Referenced to SOFR

SOFR debt issuances with a maturity greater than or equal to five years decreased in February 2021 compared to January 2021. During February 2021, there were 6 bonds issued which have a maturity between five and ten years. The issuances during February 2021 includes 14 bonds with an amount outstanding of $3.8 billion which have a maturity greater than or equal to ten years, which has decreased compared to $9.6 billion in January 2021.

There were 350 issuances of SOFR bonds outstanding worth $204.18 billion, with a maturity greater than or equal to five years, through March 10, 2021 including 267 issuances worth $109.26 billion with a term greater than or equal to 10 years.



Source: Bloomberg, compiled by Deloitte
Data as of Feb 28, 2021

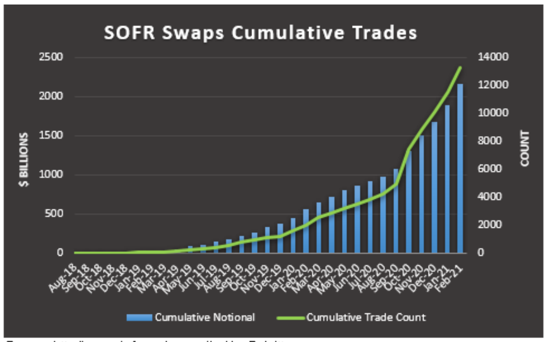
Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

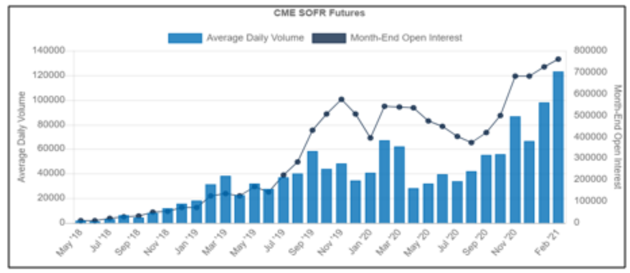
- The cumulative traded notional for SOFR based interest rate and basis swaps totaled $2,164.9 billion through February 26, 2021.
- For the month of February 2021, the notional volume of SOFR-based interest rate and basis swaps totaled $267.4 billion compared to $215.3 billion in January 2021, and $182.3 billion in December 2020.

SOFR Futures

- According to data available on CME, for February 2021, SOFR futures average daily volume reached 123K contracts/ day. The data is available **here**.
- The month-end open interest for SOFR futures as of February 2021 was around ~762K contracts.
- This represents a new high in open interest. The data is available **here**.



Source: http://swapsinfo.org/, compiled by Deloitte
*Data as of Feb 26, 2021



Source: CME Group
*Data as of Feb 28, 2021

Global IBOR Activity

The market activity in Sterling Overnight Index Average (SONIA), Swiss Average Rate Overnight (SARON), Tokyo Overnight Average Rate (TONA) 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 February 28, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US $ Billions)	Bonds Cumulative issuance amount (US $ Billions)
SONIA	35,827.9	105.1
SARON	64.4	NA
TONA	655.2	NA
€STR	110.2	5.5

Source: Bloomberg, http://swapsinfo.org/, compiled by Deloitte
Data as of February 28, 2021

Global Highlights

United Kingdom

- The FCA published Edwin Schooling Latter's speech on LIBOR cessation. The speech is available **here**.
- The Bank of England (BoE) Working Group published a consultation on the successor rate to GBP LIBOR in legacy bonds. The consultation is available **here**.
- "Her Majesty's (HM) Treasury consultation supporting the wind-down of critical benchmarks". The consultation is available **here**.
- "LIBOR transition: What is a "safe harbour" and why does the UK's legislative toolkit need one"? The article is available **here**.
- "UK Finance Guide to LIBOR Discontinuation for Banks and Lenders". The article is available **here**.

European Union

- The European Money Market Institute (EMMI) published a statement on the planned cessation of EONIA on January 3, 2022. The article is available **here**.
- The European Central Bank (ECB) Working Group has published a summary of responses by the working group on euro risk-free rates on EURIBOR fallback trigger events. The report is available **here**.
- The ECB Working Group published a summary of responses by the working group on euro risk-free rates on €STR-based EURIBOR fallback rates. The report is available **here**.
- Executive summary, minutes, and presentation materials of the February 1, 2021 Swiss Franc Working Group meeting were published. The meeting materials are available **here**.
- "Euribor fallback proposals expose divisions in loan markets". The article is available **here**.
- "European Union's Legislative Fix for the Cessation of LIBOR". The article is available **here**.
- "Financial benchmarks: European Council adopts new rules addressing LIBOR cessation". The press release is available **here**.

Asia

- The Monetary Authority of Singapore (MAS) published its Deputy Managing Director's (Markets & Development) speech on SOR to SORA transition in 2021. The speech is available **here**.
- Singapore Steering Committee for SOR & SIBOR Transition to SORA, announced further measures to boost SORA transition. The press release is available **here**.
- "More Hong Kong corporate loans linked to new rate". The article is available **here**.
- "Central clearing of SORA derivatives has been extended to 21-year tenor". The press release is available **here**.
- "Singapore sticks to end-2021 goal for LIBOR shift". The article 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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