Deloitte LIBOR Transition Newsletter
February 2021
Regulatory Updates: 01.01.21 – 01.31.21
Market Updates: 01.01.21 – 2.11.21

Deloitte[i] US LIBOR Transition Newsletter

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

Executive Summary

The International Swaps and Derivatives Association (ISDA), published an article "Countdown to New Fallbacks" in January 2021 highlighting progress across the industry related to adhering to the ISDA Protocol and the next steps still anticipated to fully prepare for the cessation of LIBOR. At the time of the article's publication, 5,900 entities across nearly 70 jurisdictions had adhered to the ISDA Protocol which incorporates new, robust fallbacks into existing derivative contracts linked to LIBOR (and other key interbank offered rates) through the updated 2006 ISDA Definitions. The ISDA Protocol and the IBOR Fallbacks Supplement are aimed to be used as a one-size-fits-all safety net to minimize the systemic impact of a permanent LIBOR cessation. Regulators are encouraging market participants to implement well-defined fallbacks and negotiate LIBOR-linked contracts in order to achieve more tailored outcomes.

New York Governor Andrew Cuomo has proposed legislation as part of the New York (NY) State budget deal expected to be voted on March 31, 2021 which will help hundreds of billions of dollars of LIBOR-linked financial contracts transition smoothly in the event of LIBOR's permanent cessation. The proposed legislation would allow contracts to replace LIBOR with a rate recommended by the Federal Reserve Board (FRB) or the Alternative Reference Rate Committee (ARRC). The proposed legislation would take immediate effect upon the passing of the budget bill. The proposal marks an important first step in the LIBOR transition as many contracts referencing LIBOR are governed under NY State law which can hopefully lead as an example for other states to follow.

An article was recently published by risk.net, describing how many dealers believe the US interest rate swap market will largely shift to a multi-benchmark space, with instruments tied to term and credit-sensitive rates as well as to regulator-recommended risk-free rates. In response to LIBOR's impending cessation, the ARRC has recommended replacing LIBOR in the swaps market with a backwards-looking, compounded Secured Overnight Funding Rate (SOFR). However, as cash products are often tied to term LIBOR and other interbank offered rates, market participants may look for derivatives to hedge the benchmarks used for these cash products.

Key Upcoming Dates

- **February 2021** – Expected FCA final recommendation on the cessation of publication of USD 1-week and 2-month LIBOR settings by end of 2021 and rest of the USD tenors' publication by June 30, 2023.
- **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 FRB or ARRC.

Our Perspective

Countdown to New Fallbacks

The significant number of entities and jurisdictions who have adopted the ISDA Protocol is a strong indicator of the momentum that is backing the current path to transition away from LIBOR. Adherence to the protocol may help reduce systemic risks when certain IBORs cease to exist or are deemed non-representative. While the ISDA Protocol became effective on January 25, 2021, market participants can still incorporate SOFR directly into their contracts to facilitate a smooth transition and alleviate concerns of disruption. Since the ISDA Protocol's fallback language is intended to be a one-size-fits-all approach, adhering parties may want to continue evaluating current contracts throughout 2021 and obtain more tailored, robust, and potentially more favorable fallbacks and products with their counterparties. Contracts should be evaluated to see if renegotiation may be needed prior to the maturity of the related product in instances in where counterparties have not adhered to the ISDA Protocol.

NY State LIBOR Discontinuation Legislation

NY Governor Andrew Cuomo's proposed legislation helps define legal guidelines for contracts that either contain no fallbacks at all or contain LIBOR-related fallback provisions that are not robust. According to the bill, such contracts may adopt the rates recommended by the FRB or the ARRC in a LIBOR cessation event. It marks a crucial legislative step to establish legal and economic certainty, particularly related to LIBOR-based mortgages and student loans with long maturities. With many LIBOR-linked products being governed under NY state law, this alleviates significant burden on the market from potential conduct risk, legal burden, and operational complexity of renegotiating the various LIBOR-linked products (such as bonds which require unanimous consent for the changes in terms). When passed, this bill can serve as a precursor for other states to enforce a similar measure to facilitate an orderly LIBOR transition. During the ARRC office hours, David Bowman (assistant director at the FRB) mentioned other states are being considered for a similar approach.

A Shift to a Multi-Benchmark World

With the overall LIBOR Transition being a market-driven initiative, the coexistence of multiple benchmark rates is probable if instruments referencing term-rates and credit-sensitive rates continue to exist. Term rates are still yet to be developed with the ARRC still going through their various request for proposals (RFPs) from vendors to publish a term rate of SOFR. David Bowman (assistant director at the FRB) mentioned the term rate may be delayed past June 2021, which is the current expected date the rate plans to begin to publish. The Credit Sensitivity Group led by the FRB also seems to not have come to a unanimous decision on a recommended credit sensitive rate replacement. The outlook by large and systemically important banks to such a multi-benchmark reality may encourage other participating institutions to confirm that their models, technologies, and systems are flexible to handle such cases to make sure that the various needs in the market can be met at a timely basis.

Regulatory Updates

Summary of ARRC Office Hours Q&A with David Bowman Federal Reserve Board (FRB)
This section represents a summary of the ARRC office hours Q&A with David Bowman from January 1, 2021 until January 31, 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:

Securities Extending Beyond LIBOR's Termination
- Asset managers can hold securities past LIBOR's termination date, which important to bear in mind especially for floating rate debt where there it is challenging to change the terms of the contract. Asset managers may need to estimate LIBOR's value at termination date to understand what the fixed rate would look like at that time in order to determine if they would like to hold the instrument. Asset managers could alternatively sell the instrument and try to buy it back, exchange it, or hold it and await a potential legislative solution. Additionally, some legacy adjustable rate mortgages (ARMs) have language that allow the noteholder to name a new rate in many instances which may have different outcomes than other floating debt.

Potential Trigger Announcements Based on Currency
- It is possible for the Intercontinental Exchange (ICE) Benchmark Administration (IBA) to announce the official decisions for another currency of LIBOR before they decide with regards to USD LIBOR. ISDA spread adjustments can be locked in upon the announcement by the IBA/ Financial Conduct Authority (FCA) that LIBOR plans to stop on a specific date or is determined to be unrepresentative (in which case the spread could be applied on the event day). The ARRC, dealing with non-consumer cash products, has also announced that their spread adjustment plans to match what is provided by ISDA. However, for ARRC consumer cash products, technical details for setting spreads have not yet been specified. Spread adjustments could be set concurrently with ISDA, or at a later date.

Term Rates for Derivative Products
- The extension of certain LIBOR tenors has raised concerns about the misalignment of cash products falling back to a term rate instead of the compound rate for derivatives. However, the term rate may be set at the market expected value of compound SOFR in arrears. There is also the option for derivatives not to fall back to a term rate in efforts to keep a hedge if desired.

Hedge Effectiveness with Compound SOFR Fallbacks
- It is likely hedge effectiveness would be maintained when a swap falls back to SOFR compounded in arrears while a loan leg falls back to a forward-looking term rate as there is a link between the forward-looking term rate and compound rate in arrears. However, the two would diverge when monetary policy suddenly changes.

Arguments For and Against a Conversion of LIBOR Swaps to Risk Free Rate Swaps
- The London Clearinghouse (LCH) and Chicago Mercantile Exchange (CME) have recently proposed converting LIBOR swaps to risk free rate swaps ahead of the termination of LIBOR currencies (by December 31, 2021) to avoid some of the operational complexities in ISDA's conversion from LIBOR to SOFR. The practical constraints that ISDA faced with regards to a protocol (including changing payment date using a lookback with a shift) led to their choice of a SOFR rate with payment delay (no spread adjustment embedded in the floating rate). Additionally, it may be easier to compress old and new swaps in the LCH/CME proposal than under the ISDA protocol conversation. The main arguments against such a solution are the cost of the conversion, low concern regarding fungibility of swaps which may not need to be compressed, and a duration difference between the ISDA and LCH/CME conversion.

Short Floating Rate Notes Prior to LIBOR's Cessation
- There is a difference in outcome for an issuer who would like to issue a short floating rate note prior to June 30, 2023 with USD LIBOR and use either the ISDA fallbacks for derivatives or ARRC fallback language. The ARRC hardwired fallback language falls back first to a term rate if one is recommended and then to compounded SOFR. The ISDA definitions, however, fall back to SOFR compounded in arrears. The ARRC's second waterfall step that different outcomes plan to be achieved unless the first fallback is contractually removed which is similar to ISDA's. Additionally, there could be differences in outcome from various other contractual terms, including the ARRC's conforming changes option for elements like look backs.

Consumer vs Non-Consumer Product Spreads

- For consumer products, the ARRC plans to have a one-year transition period. While non-consumer products can immediately jump to the new spread on the first reset date, consumer product spread adjustments plan to be based off a measure of the average of LIBOR. The recommended spread adjustment can move every day for a year in a linear fashion until it matches the long-run adjustment, upon which it can become fixed. The published rate plans to have a built-in spread adjustment so no calculation will be required.

Regulatory Highlights

- ISDA published an article highlighting progress across the industry related to adhering to the ISDA Protocol, and the work still ahead to prepare for the cessation of LIBOR. The article is available **here**.
- NY Governor Andrew Cuomo has proposed legislation which plans to help LIBOR-linked financial contracts transition smoothly in the event of LIBOR's permanent cessation. The article is available **here**.
- Risk.net published an article titled "US swap market may become multi-rate world, say dealers". The article is available **here**.

ARRC Working Group

- The ARRC published its updated legislative proposal for New York State. The draft legislation is available **here**.
- The presentation and recording of the first Credit Sensitivity Group workshop are now available. The presentation and the recording available **here** and **here**.
- The Credit Sensitivity Group second group workshop meeting occurred in January. The agenda for meeting is available **here** and additional materials will be available soon.
- The ARRC released its conventions for SOFR-based intercompany loans to support non-financial corporations through the LIBOR transition. The conventions are available **here**.
- The ARRC updated its FAQs from December 2020. The FAQs are available **here**.
- The ARRC published its December 2020 - January 2021 newsletter. The newsletter is available **here**.

ISDA Updates

- ISDA published an article urging adherence to IBOR Fallbacks Protocol. The article is available **here**.
- ISDA hosted a webinar titled "The Path Forward for LIBOR". The webinar is available **here** and the transcript is available **here**.
- ISDA released its ISDA-Clarus RFR Adoption Indicator for December 2020. The indicator is available **here**.
- ISDA's new IBOR fallbacks protocol took effect on January 25, 2021. The press release is available **here**.

CME, LCH & ICE Updates

- CME published its IBOR fallbacks and conversions discussion document. The report is available **here**.
- CME hosted a webinar on SOFR-based fallbacks for Eurodollar futures and options on January 26, 2021. The webinar is available **here**.
- "LCH plans LIBOR swap switch to Risk Free Rates". The article is available **here**.
- ICE published its Interest Rates report for December 2020. The report is available **here**.
- IBA launched the ICE term Sterling Overnight Index Average (SONIA) reference rates as a benchmark for use in financial instruments. The article is available **here**.

Other News/ Useful Reading

- "Bloomberg launches short term credit sensitive index to support IBOR transition". The article is available **here**.
- "Multi-curve Cheyette-style models with lower bounds on tenor basis spreads". The article is available **here**.
- "Vanishing liquidity, the Ronin collapse, XVAs – the pandemic wreaked havoc in risk transfer markets". The article is available **here**.
- "Approaching the endgame – What's left for completing LIBOR transition?" The article is available **here**.
- "Pandemic Delays Market's Shift From LIBOR". The article is available **here**.
- "Finance executives look to advance LIBOR transition in 2021". The article is available **here**.
- "LIBOR proving hard to kill in $200 trillion derivatives market". The article is available **here**.
- "More derivatives get accounting break to deal with LIBOR demise". The article is available **here**.
- "Global banks warn of market chaos if court abolishes LIBOR". The article is available **here**.
- "Early LIBOR shift for derivatives is weighed by clearing houses". The article is available **here**.
- "LIBOR 'Big Bang' faces headwinds". The article is available **here**.
- "LIBOR will be replaced, despite deficiencies of heir, SOFR". The article is available **here**.
- "LIBOR Risk Quarterly report for Q4, 2020". The report is available **here**.
- "Legacy benchmark risk – A robust and effective conversion mechanism". The article is available **here**.

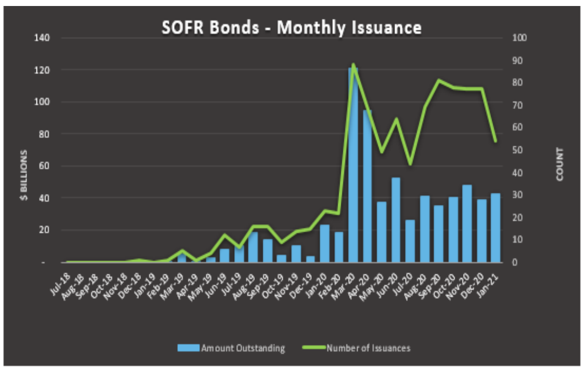
Market Updates

Increase in Debt Issuance Referenced to SOFR

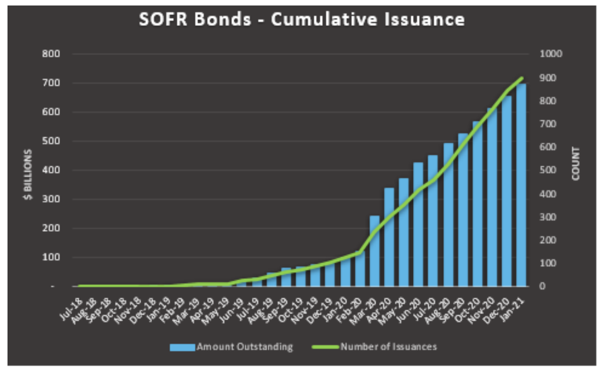
The issuance size of SOFR referenced debt increased in January 2021 compared to the issuances in December 2020. The issuance was $42.23 billion in January 2021 which increased from $38.54 billion in December 2020. The graphs below represent data through January 31, 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently $709.15 billion with 919 bonds through February 11, 2021. There were 54 new issuances in January 2021 compared to 77 in December 2020 and November 2020.

In January 2021, federal agencies issued 24 SOFR referenced Floating Rate Notes (FRNs) worth $12.86 billion. There were 30 other institutions which contributed $29.38 billion to the outstanding amount of SOFR referenced debt.



Source: Bloomberg, compiled by Deloitte
Data as of Jan 31, 2021

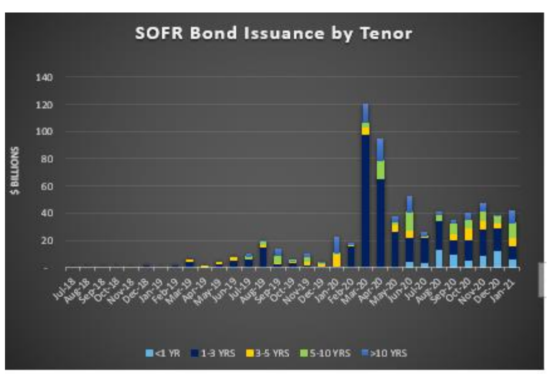


Source: Bloomberg, compiled by Deloitte
Data as of Jan 31, 2021

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

SOFR debt issuances with a maturity greater than or equal to five years increased in January 2021 compared to December 2020. During January 2021, there were 9 bonds issued which have a maturity between five and ten years. The issuances during January 2021 includes 10 bonds with an amount outstanding of $9.6 billion which have a maturity greater than or equal to ten years, which has increased significantly as compared to $608.75 million in December 2020.

There were 325 issuances of SOFR bonds outstanding worth $228.68 billion, with a maturity greater than or equal to five years, through February 11, 2021 including 253 issuances worth $163.04 billion with a term greater than or equal to 10 years.



Source: Bloomberg, compiled by Deloitte
Data as of Jan 31, 2021

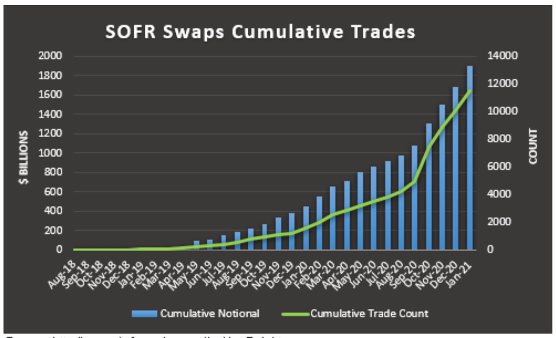
Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

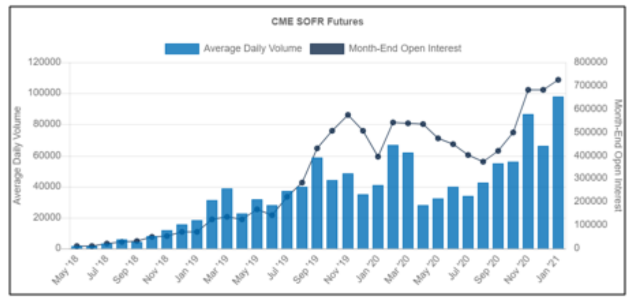
- The cumulative traded notional for SOFR based interest rate and basis swaps totaled $1,897.5 billion through January 29, 2021.
- For the month of January 2021, the notional volume of SOFR-based interest rate and basis swaps totaled $215.3 billion compared to the $182.3 billion in December 2020, and $190.4 billion in November 2020.

SOFR Futures

- As per the data available on CME, for January 2021, SOFR futures average daily volume reached 98K contracts/ day. The data is available **here**.
- The month-end open interest for SOFR futures as of January 2021 was around ~723K contracts. The data is available **here**.



Source: http://swapsinfo.org/, compiled by Deloitte
*Data as of Jan 29, 2021



Source: CME Group
**Data as of Jan 31, 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 January 31, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US $ Billions)	Bonds Cumulative issuance amount (US $ Billions)
SONIA	34,185.6	99.0
SARON	60.8	NA
TONA	620.8	NA
€STR	102.6	5.5

Source: Bloomberg, http://swapsinfo.org/, compiled by Deloitte
Data as of January 31, 2021

Global Highlights

United Kingdom

- Refinitiv launched production of the Term SONIA benchmark on January 11, 2021. The article is available **here**.
- Bank of England (BoE) Sterling Working Group published its paper on credit adjustment spread methods for active transition of GBP LIBOR loans. The report is available **here**.
- BoE published the Prudential Regulatory Authority (PRA) consultation on GBP LIBOR transition to SONIA for insurance firms. The consultation is available **here**.
- BoE published the Loans Enablers Task Force Report on the 'Path to Discontinuation of New GBP LIBOR lending by end-Q1 2021'. The report is available **here**.
- BoE published the Sterling Working Group open letter to loan system vendors and treasury management system providers. The open letter available **here**.
- BoE published the banking stress testing guidance for 2021 (section 10 for information on the LIBOR transition). The guidance is available **here**.
- Sterling Working Group published a report on transition in non-linear derivatives. The report is available **here**.
- Sterling Working Group published a **statement** and **roadmap** outlining milestones and priorities for the transition away from GBP LIBOR by the end of 2021. The press release is available **here** and roadmap available **here**.
- The FCA updated their LIBOR webpage with their view on amending reference rates or adding a fallback would not trigger the application of margin or clearing requirements under EMIR. The guidance is available **here**.

European Union

- European Central Bank (ECB)'s on-demand video of December 14, 2020 third roundtable on euro risk-free rates was published. The on-demand video is available **here**.
- "Limited exposure to LIBOR transition for European collateralized loan obligations (CLOs)". The article is available **here**.
- "Update on the proposal for a governmental IBOR transition in the European Union". The article is available **here**.
- "Slow €STR swap take-up threatens term rate fallbacks". The article is available **here**.
- "Authorities renew calls for €STR take-up". The article is available **here**.
- "EU's 'tough legacy' fix could tie risk managers' hands". The article is available **here**.

Asia

- Bank of Japan published the TONA (fixing in arrears) conventions to use in loans report. The conventions are available **here**.
- "Japan weighs benchmark options as sun sets on LIBOR". The article is available **here**.
- "Regulatory intervention needed for JPY LIBOR transition". 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

---

[i] Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be is available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.