



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 July 21, 2021, the Alternative Reference Rates Committee (ARRC) endorsed the Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee's (MRAC) recommendation that interdealer trading conventions for U.S. Dollar, Japanese Yen, Sterling, and Swiss Franc London Interbank Offered Rate (LIBOR) based cross-currency basis swaps move to each respective country's risk-free rate (RFR) by September 21, 2021. The change to cross-currency basis swap trading conventions is phase two of a four phase Secured Overnight Financing Rate (SOFR) First prioritization of trading in SOFR rather than USD LIBOR for particular market segments and products serving to help market participants reduce reliance on USD LIBOR given supervisory feedback that such activity stop by December 31, 2021. Tom Wipf, ARRC Chairman and Vice Chairman of Institutional Securities at Morgan Stanley noted, "The MRAC's SOFR First recommendations will play a key role in ensuring a smooth transition away from LIBOR. The September move of cross-currency basis swap conventions is important in recognizing that many jurisdictions will be moving from LIBOR to risk-free rates, and that creating a consistent global transition matters to many market participants".

On July 21, 2021, the ARRC conducted its fourth SOFR Symposium, an event emphasizing the significance of transition away from LIBOR to RFRs. Among the key takeaways from this event was ARRC's recommendation of the forward looking SOFR term rate scope-of-use. The ARRC recommends the use of overnight SOFR and SOFR averages for markets such as (1) floating rate notes, (2) consumer products, (3) most securitizations and (4) applications related to efficient hedging. The ARRC supports the use of term SOFR in applications where adopting overnight SOFR or SOFR averages has proven to be challenging, such as in business loans and related securitization activity. However, the ARRC did not support the use of term SOFR in derivatives market other than when related to end-user activity, citing the importance from a financial stability point of view that such markets transition to the more robust overnight RFRs.

On July 29, 2021, the House Financial Services Committee approved legislation providing a replacement mechanism for outstanding contracts tied to LIBOR. Rep. Brad Sherman, D-Calif, sponsored the Adjustable Interest Rate (LIBOR) Act of 2021 to establish a process for contracts that do not have appropriate fallback language. The act would provide relief by allowing contracts to reference the Board of Governors of the Federal Reserve's (FRB) recommended alternative - a spread-adjusted SOFR rate - to avoid costly litigation proceedings. Both parties in congress along with senior federal regulatory officials support the legislation to help ease the transition from LIBOR. The bill authorizes the FRB to issue rules around the use of SOFR in legacy LIBOR financial contracts and allows contracts to quickly move from LIBOR to SOFR without litigation. Committee Chairwoman Maxine Waters, D-Calif noted that the act "finally puts an end to LIBOR, the reference rate that Wall Street and other global banks manipulated at the expense of municipalities and consumers".

On July 29, 2021, the ARRC formally announced it was recommending the Chicago Mercantile Exchange (CME) Group's forward-looking SOFR term rates, following the shift of USD linear swap trading conventions from USD LIBOR to SOFR on July 26, 2021 as part of the SOFR First initiative. The ARRC's announcement is a key milestone in the USD LIBOR transition and provides market participants with a transition instrument that marks the completion of the Paced Transition Plan the ARRC outlined back in 2017. John C. Williams, President of the Federal Reserve Bank of New York and Co-Chair of the Financial Stability Board's Official Sector Steering Group said, "We are seeing great momentum in the transition toward SOFR and today's recommendation will undoubtedly accelerate that progress". Williams also noted that market participants need to "Keep in mind: the end of 2021 and of new LIBOR is coming quickly, so take action now to build a solid SOFR foundation and ensure you are ready".



ARRC Endorses the MRAC Recommendation for September 21, 2021 SOFR First Initiative Move

The MRAC recommendation that interdealer trading conventions for US Dollar, Japanese Yen, Sterling, and Swiss Franc LIBOR cross-currency basis swaps move to each respective country's RFR by September 21, 2021, may help encourage dealers to increase SOFR trading activity and continue to promote SOFR market liquidity. Firms may want to review this recommendation with their various business functions to confirm the areas are ready for issuing and solely trading RFR based cross-currency swaps as per the recommendation by MRAC.

ARRC Announces SOFR's Scope-of-Use

The ARRC's announcement on the scope-of-use for SOFR comes in time, as market conventions in multiple markets are expected to switch to SOFR before the end of the year. The recommendations create a clear distinction between the use of overnight SOFR and SOFR averages versus the use of term SOFR rate. The recommendations also indicate ARRC's preference that market participants rely on overnight SOFR and SOFR averages wherever possible in order to create a robust rate that is required for financial stability.

House Committee Advancing Bill to Address LIBOR Transition

Congressional support for LIBOR transition to SOFR may likely help avoid costly litigation proceedings for market participants who may not have appropriate fallback language incorporated within their financial contracts. By providing legal relief for "tough legacy" contracts, contracts that reference LIBOR but do not include viable fallback language in the event of LIBOR's cessation, we believe this can reduce uncertainty surrounding legacy contracts post LIBOR cessation. This legislation builds on the New York State LIBOR legislation, with key differences being federal legislation may use the FRB's recommended rate rather than that recommended by the ARRC, it would deal with the transition on a national level for all state contracts, and it would address concerns around the Trust Indenture Act of 1939 limitation on contract modifications.

ARRC Formally Recommends the CME Term Rate

The ARRC's formal recommendation of the CME Group's forward-looking SOFR term rate is a key milestone of the USD LIBOR transition and provides market participants with a transition tool that marks the completion of the Paced Transition Plan the ARRC outlined back in 2017. The SOFR First Initiative successful convention change, along with the continued growth in both SOFR cash and derivative markets, ultimately allowed the ARRC to recommend SOFR term rates. The SOFR term rate is the first rate in the hardwired benchmark replacement in the ARRC's recommended fallback language, so it is beneficial to have the first step of the waterfall readily available. Firms should review their product inventory on which were pending the inclusion of the SOFR term rate, although the necessity of the term rate in those products should also be considered as per the ARRC's recommendations on the scope-of-use.



Regulatory Updates

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

This section represents a summary of the ARRC office hours Q&A with David Bowman from July 1, 2021 until July 31, 2021. 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:

Considerations for Legacy LIBOR Loans with Zero Floor

- The ARRC recommendation is to floor the sum of the daily simple SOFR rate and the spread. SOFR is generally lower than LIBOR (which is why there is a spread adjustment) and therefore the value equivalent is the spread of daily adjusted SOFR. To minimize value transfer, one would have to apply the floor for the LIBOR rate on the spread adjusted SOFR rate.

Spread Calculations for Loans with Varying Tenors

- The ARRC recommended that one should use the spread for the applicable tenor. If there is a quasi-rate, the contract should spell how to calculate the rate. For example, if it takes a half of a week LIBOR and 2 weeks of a one-month LIBOR, one would calculate the same way the SOFR and the spread in the same proportion.

Where to Find Term-SOFR Rate

- The main avenue the ARRC sees retail customers looking up the rate would be through its selected vendor, Refinitiv, that won the RFP to publish the rates and spread adjustment for cash products. Currently, Refinitiv is working on a site which will be available to retail customers that will be user friendly.

LIBOR Replacement for Business Loans v/s Consumer Loans

- Any ARRC recommended fallback will have the spread adjustment. Both for a business loans and a consumer loan that matches in tenor, the expectation will be one-month LIBOR would fallback to one-month spread adjusted SOFR. The intent is to keep the tenors the same for fallbacks. The spread adjustment for business loans is a fixed number versus consumer loans which have a one-year transition in the spread adjustment. Regardless of in arrears, term or other, the spread will be the same ISDA spread.

Expected Changes to the Scope-of-Use for ARRC's Term SOFR Recommendation

- The scope of use for ARRC's term SOFR recommendation that was released was intended to be the final version. There may be a frequently asked questions created and may be shared at a later time to clarify outstanding questions.

Term SOFR for Consumer Products and Floating Rate Notes

- The ARRC officially recommended the CME term SOFR rate. For legacy products, the ARRC supports the use of term SOFR as a fallback for floating rate notes and other products and has said this in all its recommended fallbacks as the first step in the waterfall and in the NYS legislation. For new issuances in cash products, the ARRC has generally recommended the use of overnight SOFR/SOFR averages and encourages to users to continue to use those rates in cash markets. The ARRC has explicitly said that it does recommend term usage in new business bilateral loan market due to the difficulty in the transition as well as in the securitization and derivative markets (especially when trying to hedge to a term SOFR cash product). In consumer products, the ARRC is not recommending the use of term rates.

Best Practices for Interdealer Market

- The ARRC's intent is to make sure the vast majority of derivatives stay in the overnight market and avoid interdealer participants taking advantage of the exemption for end-user activity. The ARRC is still testing out the parameters for end-users to prevent opening the door to interdealer market going to term SOFR.

Regulatory Highlights

- The ARRC endorsed the CFTC MRAC's recommendation that interdealer trading conventions for LIBOR based cross-currency basis swaps move to each respective country's RFR. The statement is available [here](#).
- The ARRC's fourth SOFR symposium held on July 21, 2021 covered the SOFR first initiative and the progress towards formally recommending the CME SOFR Term Rates. The statement is available [here](#) and webcast available [here](#).
- The House Financial Services Committee approved legislation providing a replacement mechanism for outstanding contracts tied to LIBOR. The article is available [here](#).
- The ARRC has formally recommended CME Term SOFR. The press release is available [here](#) and SOFR term sheet available [here](#).

ARRC Updates

- The ARRC published a statement welcoming the Federal Housing Finance Agency (FHFA) supervisory letter to Federal Home Loan Banks to support a smooth transition away from USD LIBOR. The statement is available [here](#).
- The ARRC published a statement commending the CFTC Market Risk Advisory Committee's formal adoption of a recommendation on transitioning interdealer derivatives market trading conventions to SOFR. The statement is available [here](#).
- The ARRC recommended loan conventions and best practices for use of forward-looking SOFR term rate to accelerate the transition away from LIBOR. The statement is available [here](#).
- The ARRC published its June/July newsletter. The newsletter is available [here](#).

International Swaps and Derivatives Association (ISDA) Updates

- ISDA published updates to the 2006 ISDA definitions in the self-compounding RFR section (supplement 77). The updated definitions and the LIBOR Infohub is available [here](#).
- ISDA published the "ISDA-Clarus RFR Adoption Indicator" for June 2021. The report is available [here](#).
- ISDA published an article titled "The LIBOR end game". The article is available [here](#).
- The new ISDA/ Brattle Group website was launched for LIBOR fallbacks. The website is available [here](#).
- ISDA announced the results of consultation on fallbacks for ICE Swap Rates. The report is available [here](#).
- ISDA published the "ISDA in Review for June 2021". The report is available [here](#).

CME Updates

- CME published the CME July 2021 Rates Recap. The newsletter is available [here](#).
- Risk.net published an article titled "CME's term SOFR rate gets the official nod". The article is available [here](#).
- "CME Mexican Interbank Equilibrium Interest Rate (F-TIIE) futures and FX hedging with SOFR futures". The articles are available [here](#).

Other News/ Useful Reading

- Financial Stability Board published the progress report on LIBOR transition issues. The report is available [here](#).
- CFTC issued a statement on transitioning away from LIBOR. The statement is available [here](#).
- "Time to end debate on SOFR alternatives, participants warn". The article is available [here](#).
- Bloomberg published the BSBY July 1, 2021 report. The report is available [here](#).
- "Transitioning from LIBOR to Risk Free Rates". The article is available [here](#).
- "Mid-year check in on LIBOR transition developments". The article is available [here](#).
- "LIBOR Transition: Potential higher interest rates and resultant job cuts". The article is available [here](#).
- "Transition disruption possible with no clear successor to USD LIBOR". The article is available [here](#).
- "Structured finance new issuance slow to move away from USD LIBOR". The article is available [here](#).
- "Ask us first before swapping Libor with 'risk-laden' rate, says UK watchdog". The article is available [here](#).
- "FCA warns against use of 'credit-sensitive' rates in place of LIBOR". The article is available [here](#).
- "Fractured LIBOR transition halts US structured rates switch". The article is available [here](#).
- "LIBOR transition in the loan market frequently asked questions". The FAQ's are available [here](#).
- "BlackRock and JP Morgan execute first electronic SOFR swap with Tradeweb". The article is available [here](#).
- "LIBOR is ending, and corporates need to know their options". The article is available [here](#).
- "US could benefit from copying EU Benchmarks Regulation as market moves to shaky LIBOR successors". The article is available [here](#).
- The New York Fed published their audit group's statement on IOSCO compliance. The article is available [here](#).
- "A discretisation approach for both backward- and forward-looking interest rate derivatives is proposed". The article is available [here](#).
- "No mandate, no problem: SOFR swaps embrace clearing". The article is available [here](#).



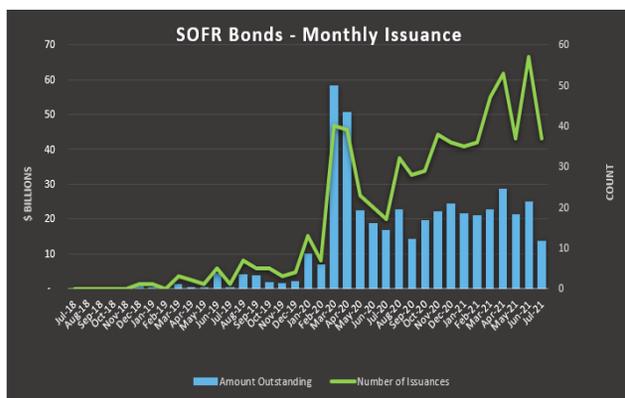
* Please note that the change in numbers and trend lines for bonds compared to figures in previous newsletters is due to change in the data source. Issuance data for bonds has been sourced from Reuters.

Decrease in Debt Issuance Referenced to SOFR

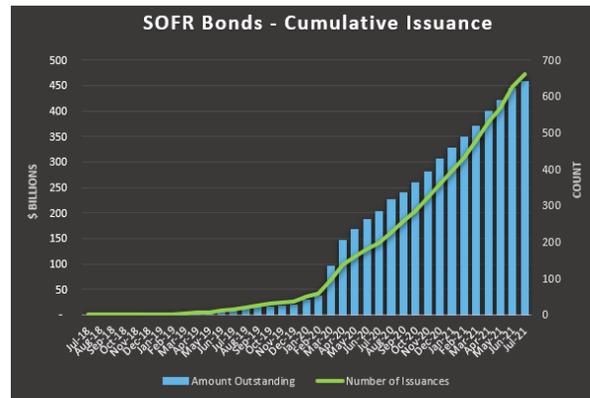
The issuance of SOFR referenced debt decreased in July 2021 compared to issuance in June 2021. The issuance size was \$13.47 billion in July 2021, which decreased from \$24.99 billion in June 2021. The graphs below represent data through July 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently \$466.55 billion with 686 bonds through August 11, 2021. There were 37 new issuances in July 2021 compared to 57 in June 2021 and 37 in May 2021.

In July 2021, federal agencies issued 24 SOFR referenced Floating Rate Notes (FRNs) worth \$10.04 billion. There were 13 issuances from other institutions which contributed \$3.43 billion to the outstanding amount of SOFR referenced debt.



Source: Reuters, compiled by Deloitte
*Data as of July 31, 2021

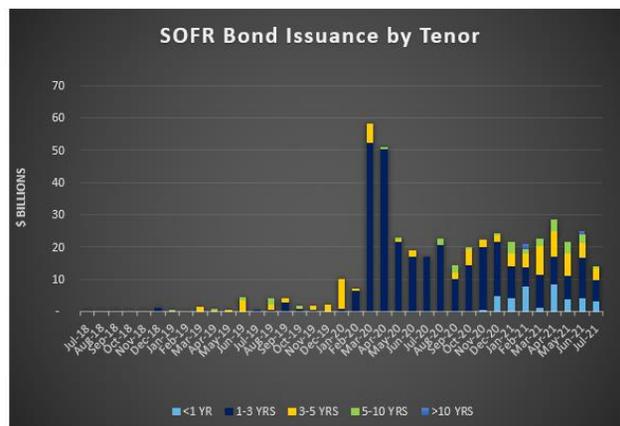


Source: Reuters, compiled by Deloitte
*Data as of July 31, 2021

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 July 2021 compared to June 2021. During July 2021, there were 2 bonds issued which have a maturity between five and ten years. There were 2 issuances during July 2021 that have a maturity greater than or equal to ten years, as was the case for June 2021.

There were 57 issuances of SOFR bonds outstanding worth \$33.65 billion, with a maturity greater than or equal to five years, through August 11, 2021 including 7 issuances worth \$3 billion with a term greater than or equal to ten years.

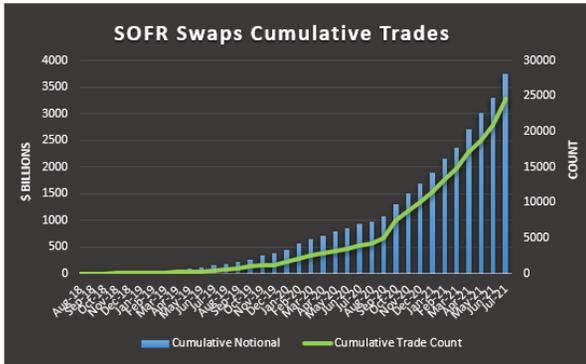


Source: Reuters, compiled by Deloitte
*Data as of July 31, 2021

Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

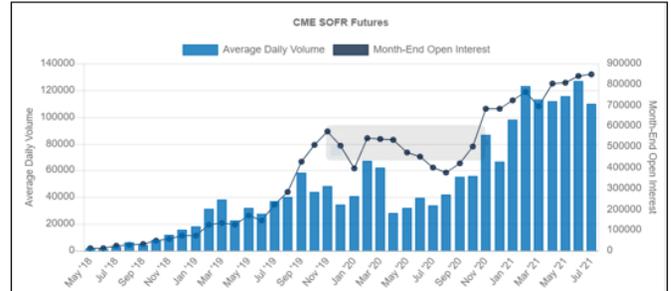
- The cumulative outstanding notional amount for SOFR based interest rate and basis swaps totaled \$3,743 billion through July 31, 2021.
- For the month of July 2021, the notional volume of SOFR-based interest rate and basis swaps totaled \$443 billion compared to \$293 billion in June 2021 and \$289.4 billion in May 2021.



Source: <http://swapsinfo.org/>, compiled by Deloitte
*Data as of July 31, 2021

SOFR Futures

- According to data available on CME, for July 2021, SOFR futures average daily volume reached 110K contracts/ day. The data is available [here](#).
- The month-end open interest for SOFR 1-month and 3-month futures as of July 2021 was ~847K contracts.



Source: CME Group
*Data as of July 31, 2021

Global IBOR Activity

The market activity in SONIA, Swiss Average Rate Overnight (SARON), Tokyo Overnight Average Rate (TONAR) 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 July 31, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US \$ Billions)	Bonds Cumulative issuance amount (US \$ Billions)
SONIA	40,854.0	128.16
SARON	98.2	NA
TONAR	774.7	NA
€STR	252.1	5.8

Source: Reuters, <http://swapsinfo.org/>, compiled by Deloitte
Data as of July 31, 2021



Global Highlights

United Kingdom

- The Financial Conduct Authority (FCA) and Bank of England (BoE) support and encourage liquidity providers in the LIBOR cross-currency swaps market to adopt new quoting conventions for interdealer trading based on risk-free rates (RFRs) instead of LIBOR. The press release is available [here](#).
- The FCA has published a consultation on proposals to modify the list of derivatives subject to the Derivatives Trading Obligation (DTO) in line with Articles 28 and 32 of UK Markets in Financial Instruments Regulation (MiFIR). The consultation is available [here](#).
- BoE published their financial policy summary and the record of Financial Policy Committee June 30, 2021 meeting. The report is available [here](#).
- Keynote speech was delivered by Edwin Schooling Latter – Director of Markets and Wholesale Policy at FCA titled: “LIBOR – 6 months to go”. The speech is available [here](#).
- BoE published the July 2021 Financial Stability Report. The report is available [here](#).
- BoE Working Group on Sterling Risk Free Rates (RFR-WG) Group published their June newsletter. The newsletter is available [here](#).

European Union

- Swiss National Bank (SNB) published the executive summary of July 1, 2021 meeting of the National Working Group on Swiss Franc Reference rate. The meeting minutes are available [here](#).
- “European banks’ LIBOR tail risks subside”. The article is available [here](#).
- Letter from the Chairman of the Euro RFR Working Group chairman to the European Commission regarding transition from EONIA to €STR was published. The correspondence is available [here](#).
- “Euro RGR Group issues a call for a statutory EONIA fix”. The article is available [here](#).
- European Securities and Markets Authority (ESMA) issued a new Q&A’s on MiFIR data reporting. The report is available [here](#).
- “Citi and Societe Generale execute first SARON/SOFR swap with LCH SwapAgent”. The article is available [here](#).
- “Swiss LIBOR referencing to end for new issues”. The article is available [here](#).

Asia

- The Association of Banks in Singapore (ABS) released a Singapore Overnight Rate Average (SORA) guide for corporates and small and medium enterprises (SMEs). The guide is available [here](#).
- The Japanese sub-group for Term Reference Rates announced a TONA First initiative. The announcement is available [here](#).
- Steering Committee for SOR & SIBOR Transition to SORA (SC-STTS) published their recommendations for the transition of legacy SOR contracts. The report is available [here](#) and the media release is available [here](#).
- “Much work remains in countdown to JPY LIBOR transition deadline”. The article is available [here](#).
- “Japan banks accelerating efforts to shift away from Yen LIBOR”. The article is available [here](#).
- ABS published the SOR compression/conversion cycle forecast. The report is available [here](#).
- “Much work remains in countdown to JPY LIBOR transition deadline”. The article is available [here](#).
- The Reserve Bank of India (RBI) advised banks to prepare for 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](#)

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