Deloitte LIBOR Transition Newsletter
June 2021
Regulatory Updates: 05.01.21 – 06.11.21
Market Updates: 05.01.21 – 06.16.21

Deloitte[i] US LIBOR Transition Newsletter

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

Executive Summary

On May 21, 2021, the Alternative Reference Rates Committee (ARRC) announced the selection of the Chicago Mercantile Exchange (CME) Group as the administrator of the forward-looking Secured Overnight Financing Rate (SOFR) term rate, provided that identified market indicators were met. The CME Group's submission was evaluated to be the strongest proposal based on (1) technical criteria, (2) firm criteria, (3) public policy criteria, and (4) calculation methodology. The ARRC's announcement of a term rate administrator builds on the ARRC's term rate principles (announced by the ARRC on April 20, 2021) and term rate market indicators (announced by ARRC on May 6, 2021), and collectively provides clearer guidance to recommend a SOFR term rate in the near future. The CME Group expressed their pleasure and a strong intent to deliver the term rate referring to their "deep and liquid underlying SOFR futures market". The CME group is also already publishing 1-month, 3-month, and 6-month SOFR term rates for the limited use in cash markets until June 30, 2023.

The ARRC released a guide to published SOFR averages intended to (1) provide market participants with key information on LIBOR transition, (2) instruct market participants on how to use the published SOFR averages, and (3) advise participants on market factors that should be considered before selecting an alternative rate. The ARRC noted their intent to equip borrowers with the context they need to understand the SOFR-based loans they can receive from lenders. This comes in response to the ARRC's survey published in March 2021, in which 90% of the respondents (nonfinancial corporates) preferred the option to choose from SOFR-based rate choices including SOFR averages applied in-advance or in-arrears.

The Commodity Futures Trading Commission's (CFTC) Market Risk Advisory Committee's (MRAC) interest rate benchmark reform subcommittee voted to recommend a market risk best practice for switching interdealer trading conventions for US Dollar interest rate swaps. Referred to as "SOFR First", the recommendation is modeled after UK's Sterling Overnight Index Average (SONIA) First initiative, and proposed that, starting July 26, 2021 interdealer brokers may consider replacing trading of LIBOR linear swaps with trading of SOFR linear swaps. The ARRC applauded the subcommittee's effort to accelerate the transition from LIBOR and noted that once the recommended switch is in place the market indicators will have been met, in turn allowing the ARRC to formally recommend a term-SOFR rate shortly thereafter.

On June 11, 2021, US Secretary of the Treasury Janet Yellen presided over the meeting of the Financial Stability Oversight Council (FSOC). Among a broad set of topics, some of the spotlight was shared by the LIBOR Transition, and the work carried out by ARRC to aid the transition such as drafting the fallback language, developing conventions for the use of SOFR, advancement in the SOFR derivatives market and proposal of the NYS legislation. Secretary Yellen pointed to areas of concerns such as the slow pace of progress in business loans and market participants' choice of alternatives rates that may lack sufficient transaction volumes. The secretary backed SOFR by calling it a robust rate suitable for use in most products with transaction volumes unmatched by other LIBOR alternatives.

The Financial Stability Board (FSB) in collaboration with its Official Sector Steering Group (OSSG) published a report welcoming the progress made by public authorities and private sector working groups in transitioning to robust Overnight Risk-Free Rates (RFRs). The report also highlighted the importance of transitioning to Overnight RFRs rather than term rates for interest rates derivatives markets for a number of reasons including: (1) the large (and highly leveraged) proportion of derivatives market's exposure to interest rate derivatives, (2) lack of possibilities for manipulation of Overnight Index Swap (OIS) rates, (3) the requirement of deep and liquid derivatives markets that rely on overnight RFRs, and (4) the possibility of conflict of interest among participants choosing term rate in derivatives.

On May 24, 2021, CME Group announced that it will launch interest rate futures based on the Bloomberg Short-Term Bank Yield Index (BSBY). Per CME, the choice to launch the BSBY futures was in response to clients' demands and concerns over price discovery and risk hedging of the BSBY index. These contracts will be available for trading in Q3 of 2021. Market participants showed support to this announcement by CME by calling it "a promising development for FICC market structure", "a strong complement to the SOFR-linked instruments", and "an important step forward in the transition away from USD LIBOR". However, on June 11, 2021, the Chairman of US Securities and Exchange Commission (SEC), Gary Gensler, expressed his concerns over the adoption of BSBY and highlighted its similarities to LIBOR, in that both rates are based upon unsecured, term, bank-to-bank lending. The Chairman expressed that he doesn't believe BSBY meets "the standard".

Our Perspective

CME Elected as Administrator of Forward-Looking Term SOFR
The ARRC's selection of the CME group as the administrator for SOFR term rate after a comprehensive review of submitted proposals comes as a sign that a term SOFR rate will soon be recommended. Given the CME Group's deep presence in the SOFR derivatives market, and owing to the fact that the 1-month, 3-month, 6-month SOFR term rates are already being published by CME for cash product use and ARRC's contractual fallback language, this announcement should provide market participants with the additional certainty they require to further develop the SOFR issuance and swap market.

The ARRC Releases a Guide to Published SOFR Averages
The ARRC's guide on published SOFR averages intend to assist borrowers, especially nonfinancial corporates, with the knowledge on how to commence their individual LIBOR transitions and provide information on how to use the SOFR averages suitable to their respective requirements. With approximately 6-months remaining until the permanent cessation of some USD-LIBOR tenors at the end of 2021, the document comes at an opportune time, is user-friendly, and acts as a much-anticipated tool expected to be widely used in the industry.

CFTC's SOFR First Approach for Interdealer Swaps
The CFTC's "SOFR First" recommendation for switching interdealer swaps to SOFR as early as July 26, 2021 comes as an attempt to increase SOFR-linked trade volumes ahead of the final cessation date at year-end. The timing of this announcement is particularly important as the transition to SOFR has been slower than expected thus far, with SOFR-swaps representing less than 2% of US trade volume since the beginning of this year. In contrast, more than 50% of sterling swaps are linked to the UK equivalent SONIA. The CFTC's recommendation will motivate dealers trading on their platforms, which accounts for a substantial share of market activity, to transition away from LIBOR thus promoting SOFR liquidity in the markets and driving the broader LIBOR transition in the US. These anticipated increased volumes in trading in the derivatives market should further assist CME to build the SOFR term rate for use outside of just cash products, which is much anticipated by the market.

No Shortage of Regulatory Guidance and Perspectives
Alongside the CFTC's "SOFR First" initiative, highlighting the importance of SOFR during the FSOC meeting, and, the importance of relying on overnight rates rather than term rates in the FSB report, indicates that there is no shortage of guidance and perspectives from regulators all over the globe. In recent weeks, such guidance serve as important precursors to key upcoming milestones such as the recommendation of Term-LIBOR, and eventually towards LIBOR cessation.

Current Market Developments for Credit Sensitive Alternative Rates (CSRs):
The market participants' interest in CSRs gained momentum after the second webinar of ARRC's SOFR Symposium, in which a recommendation of term-SOFR seemed unlikely. This made CSRs attractive to some market participants as it possessed the features of credit sensitivity and term structure. Now, a few weeks since the SOFR Symposium, not only has the ARRC announced observable and measurable market indicators for the term-SOFR rate, but have said that the recommendation of term-SOFR will be made within "days not weeks" of the SOFR First switch on July 26th. Despite the eventual term-SOFR rate, and SEC's concerns over BSBY, there seems to be some interest to develop a market for BSBY from a price discovery and hedging point of view. The scale and speed of market development of CSR's will be clear after the SOFR First initiative takes effect.

Regulatory Updates

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

CME Term Rate for Cash Products

- The CME announced term rates would be licensed for cash products for free for five years and would not license it for derivatives until June 30, 2023. This was an attempt to keep the focus on cash markets in line with the ARRC principles.

The CME as Term SOFR Administrator

- The ARRC has previously set three indicators that would provide enough confidence to officially recommend a term SOFR rate. This guideline was intended to provide clarity regarding associated timelines and needed conditions to be able to recommend a term SOFR rate. The three indicators are 1) continued growth in SOFR derivatives 2) best practice recommendations to be implemented and 3) increase volumes of actual SOFR cash products. The ARRC is not yet recommending term rates, but once conditions are met, the ARRC plans to recommend the CME rates.

New York State (NYS) Legislation and ARRC Waterfall Conventions

- The ARRC's fallback language and waterfall structure was publicly commented on and reviewed and was intended to align with the proposed NYS legislation language. The ARRC plans to release additional language to help clarify any differences and ensure the ARRC recommended fallback language is clear without discrepancies from the NYS legislation which would cause confusion.

Other Products Not Explicitly Mentioned in ARRC Releases

- The ARRC intends to clarify categorization of product types described in each of its publications and may need to create an additional generic "other" category to address product types not already explicitly commented on.

CME and London Clearing House (LCH) Approach to Settling Swaps

- It is helpful to all market participants when the two central counterparties (CCPs) can align on issues related to USD LIBOR as both CME and the LCH have worked hard to do so to date. The CME and LCH have both laid out similar processes to discuss their plans and receive feedback from market participants as it applies to USD LIBOR.

Intent of Revised Fallback Language

- The ARRC had produced revised fallback language largely due to supervisory expectations. The ARRC believed that hardwired language would be a preferable solution that offered clarity from the start and limited the need for further negotiations. However, a waterfall was needed due to the existing unknowns at the time the language was written. The revised language intends to fill in the blanks and simplify the language as more information is made available.

Hedging Cash Products with Term Rate

- There is a specific way to hedge cash products as detailed in the ARRC's user guide on this topic. The only real basis is derived from the rate received on the swap on the quarter might not perfectly match the term rate (although would be relatively close). It may be simpler and easier to hedge on a SOFR in arrears loan and swap it. The ARRC's user guide has detailed a method to hedge term SOFR rates in the cash market with an in-arrears swaps. The only basis difference is the relatively minor difference between the swap rate received and the term rate on the cash product. A simpler and easier way to hedge would be to do the loan on an in-arrears basis and swap it.

Daily Simple SOFR

- Daily simple SOFR is calculated on each business day by taking the rate to the outstanding principle for the applicable days associated with that rate (similar to a prime loan or overnight rate). The next business day's rate is pulled and applied to the principal (this is not pulling an average compound rate). Additional information can be found in the ARRC's conventions for business loans. Over the interest period rate, this methodology mathematically amounts to a simple SOFR average. However, the ARRC does recognize that the second step can be adjusted to 30-day average without losing Safe Harbor protections.

Regulatory Highlights

- The ARRC announced the selection of the CME Group as the administrator of the forward-looking SOFR term rate, provided that identified market indicators are met. The press release is available **here**.
- The ARRC released a guide to published SOFR averages intended to provide market participants with key information on LIBOR transition, instruct market participants on how to use the published SOFR averages, and advise participants on market factors that should be considered before selecting an alternative rate. The press release is available **here**.
- The CFTC MRAC's Interest Rate Benchmark Reform Subcommittee voted to recommend a market risk best practice for switching interdealer trading conventions for US Dollar interest rate swaps**.** The MRAC and ARRC press releases are available **here** and **here**.
- The US Treasury published the remarks by the Secretary of the Treasury Janet L. Yellen to the FSOC on LIBOR Transition. The remarks of the Secretary are available **here**.
- The FSB released a report titled "Interest rate benchmark reform: Overnight risk-free rates and term rates". The full report is available **here**.
- The SEC published a press release of the remarks made by its Chairman on LIBOR Transition. The press release is available **here**.
- The CME Group announced the launch of its BSBY futures in Q3 2021. The announcement is available **here**.

ARRC Updates

- The ARRC published a set of market indicators that it will consider in recommending a forward-looking SOFR term rate. The press release is available **here**.
- The ARRC released the second ARRC Event in its series: "The SOFR Symposium: The Final Year". The webinar is available **here**.
- The ARRC released the transcript of remarks at the SOFR Symposium: The Final Year (Part II) by the FRB President. The transcript is available **here**.
- The ARRC webinar, "The SOFR Symposium: The Final Year", was hosted on June 8, 2021. The session details are available **here**.
- The ARRC's updated FAQs are now available. The FAQs are available **here**.
- The ARRC released its April-May newsletter. The newsletter is available **here**.

International Swaps and Derivatives Association (ISDA) Updates

- ISDA published its report on the "Transition to RFRs Review: First Quarter of 2021". The report on trading volumes is available **here**.
- ISDA published the SwapsInfo first quarter of 2021 report. The report is available **here**.
- ISDA released a video titled: "Introduction to the 2021 ISDA Interest Rate Derivatives Definitions". The webcast is available **here**.
- ISDA's annual general meeting updates are now available:
    - i. Day 1 - covering sessions on LIBOR transition, alternative reference rates, diversity in derivatives markets and the forthcoming introduction of the 2021 ISDA Interest Rate Derivatives Definitions. The report is available **here**.
    - ii. Day 2 – covering benchmark reform in Japan. The report is available **here**.
    - iii. Day 3 – covering alignment between derivatives and securities financing transaction markets. The report is available **here**.
- ISDA published the ISDA Clarus RFR Adoption Indicator for April 2021. The report is available **here**.
- ISDA published the ISDA Swaps-Info Weekly Analysis. The data is available **here**.
- ISDA released episode 10 of their podcast titled "Adapting to Change" covering the LIBOR transition. The podcast is available **here**.
- ISDA published a report on key trends in the OTC derivatives markets in the second half of 2020. The report is available **here**.

Intercontinental Exchange (ICE)/CME Updates

- ICE Benchmark Administration (IBA) released a consultation on potential cessation of the ICE Swap Rate based on GBP LIBOR. The consultation is available **here**.
- ICE published its April interest rates report. The report is available **here**.
- ICE hosted a webinar titled "LIBOR cessation: Preparing for the future". The webinar is available **here**.
- CME Group launched peso-denominated, monthly futures contracts based on the Central Bank of Mexico's overnight Interbank Interest Equilibrium Rate (TIIE) funding rate. The press release is available **here**.
- CME to launch Bloomberg Short-Term Bank Yield Index in Q3 2021. The announcement is available **here** and press release is available **here**.
- CME published the May 2021 Rates Recap. The data is available **here**.

Other News/ Useful Reading

- "Corporates remain on swaps fallback side-lines". The article is available **here**.
- "ARRC's Wipf 'puzzled' by appeal of LIBOR-like benchmarks". The article is available **here**.
- "Treasury Issuance Could Aid Adoption of SOFR Benchmark". The article is available **here**.
- "The US is inching towards an official term replacement for LIBOR". The article is available **here**.
- "Three quarters of financial institutions unprepared for LIBOR transition – survey". The article is available **here**.
- "U.S. benchmark rate committee sets out path for SOFR forward rate". The article is available **here**.
- "The race for LIBOR replacement is too close to call". The article is available **here**.
- "LIBOR replacement race clouded by multiple alternatives". The article is available **here**.
- "Sales of U.S. Collateralized Loan Obligation (CLO) refinancing and resets have surged". The article is available **here**.
- "Treasury might hold off debt-cap reckoning to at least October". The article is available **here**.
- "LIBOR replacements multiply in shift that could fracture markets". The article is available **here**.
- "Credit Default Swap (CDS) market prepares to join LIBOR transition". The article is available **here**.
- "Markit launched a credit-sensitive SOFR alternative". The article is available **here**.
- "Clock auctions could cut basis risk and ease $74Tn Libor shift". The article is available **here**.
- "Market fragmentation from multiple rates and conventions and the impact". The article is available **here**.
- "Analysis on the US rules to fix tough legacy contracts". The article is available **here**.

Market Updates

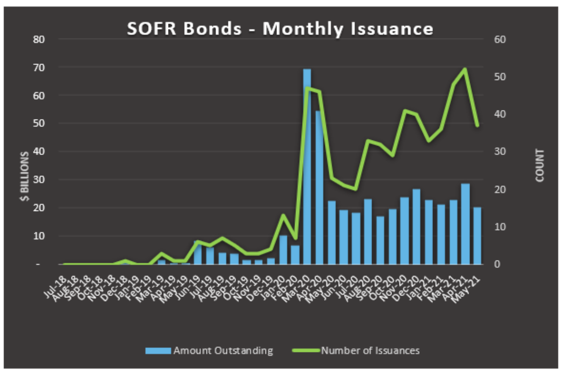
** Please note that the change in numbers and trend lines for bonds compared to figures in previous newsletters is due to change in the data source. Issuance data for bonds has been sourced from Reuters.*

Decrease in Debt Issuance Referenced to SOFR

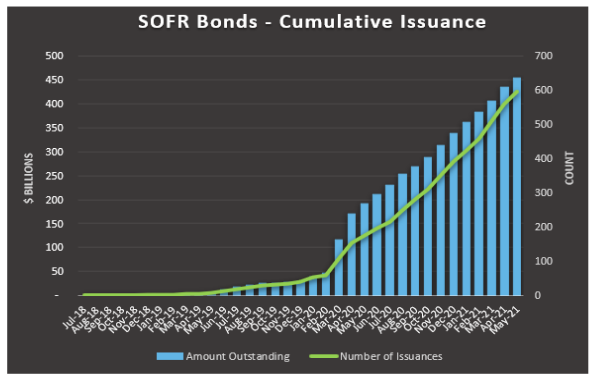
The issuance of SOFR referenced debt decreased in May 2021 compared to issuance in April 2021. The issuance size was $20.27 billion in May 2021, which decreased from $28.41 billion in April 2021. The graphs below represent data through May 31, 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently $455.72 billion with 616 bonds through June 16, 2021. There were 37 new issuances in May 2021 compared to 52 in April 2021 and 48 in March 2021.

In May 2021, federal agencies issued 21 SOFR referenced Floating Rate Notes (FRNs) worth $9.75 billion. There were 16 issuances from other institutions which contributed $10.52 billion to the outstanding amount of SOFR referenced debt.



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

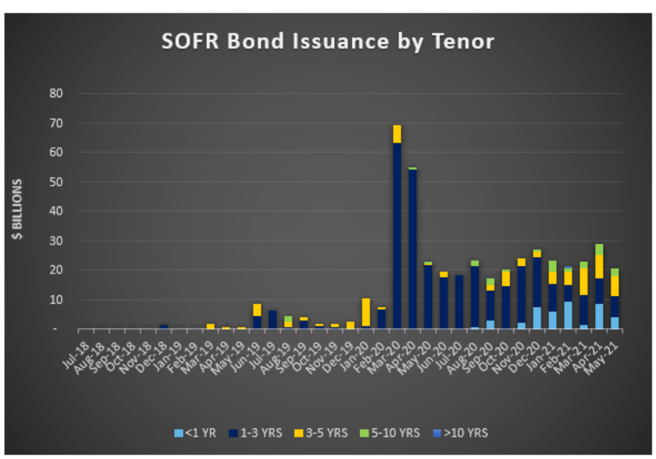


Source: Reuters, compiled by Deloitte
**Data as of May 31, 2021*

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 May 2021 compared to April 2021. During May 2021, there were 6 bonds issued which have a maturity between five and ten years. There were no issuances during May 2021 that have a maturity greater than or equal to ten years, as was the case for April 2021.

There were 43 issuances of SOFR bonds outstanding worth $20.73 billion, with a maturity greater than or equal to five years, through June 16, 2021 including 4 issuances worth $1.27 billion with a term greater than or equal to 10 years.



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

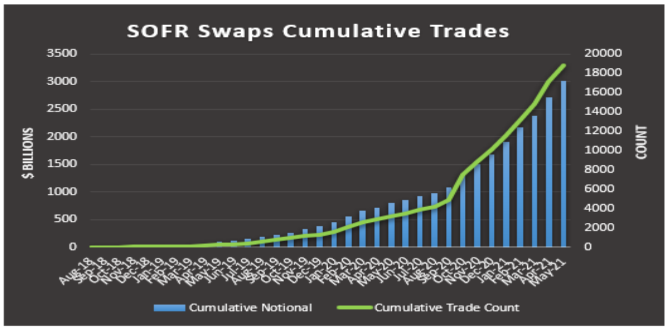
Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

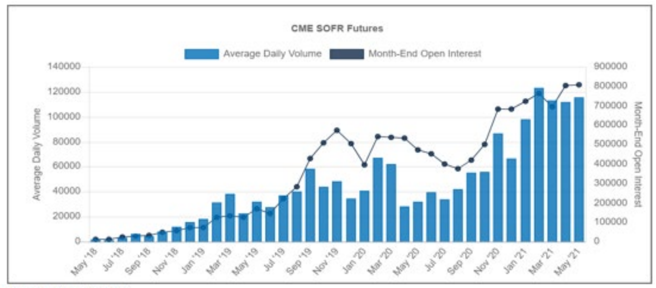
- The cumulative outstanding notional amount for SOFR based interest rate and basis swaps totaled $3,007 billion through May 31, 2021.
- For the month of May 2021, the notional volume of SOFR-based interest rate and basis swaps totaled $289.4 billion compared to $345.8 billion in April 2021, and $206.9 billion in March 2021.

SOFR Futures

- According to data available on CME, for May 2021, SOFR futures average daily volume reached 116K contracts/ day. The data is available **here**.
- The month-end open interest for SOFR 1 month and 3 month futures as of May 2021 was ~808K contracts.



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



Source: CME Group
Data as of May 31, 2021

Global IBOR Activity

The market activity in 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 May 31, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US $ Billions)	Bonds Cumulative issuance amount (US $ Billions)
SONIA	38,444.8	118.4
SARON	70.8	NA
TONA	714.7	NA
€STR	195.4	5.9

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

Global Highlights

United Kingdom

- The Bank of England (BoE)'s Working Group on Sterling Risk-Free Reference Rates (RFR WG) published its April 2021 monthly newsletter. The newsletter is available **here**.
- BoE's RFR WG published a statement on the recommendation of successor rate for fallbacks in bond documentation referencing GBP LIBOR. The statement is available **here**.
- BoE issued a consultation on proposal to modify the scope of contracts subject to the derivatives clearing obligation. The consultation is available **here**.
- UK's Financial Conduct Authority (FCA) and BoE issued statements to market participants in a switch to SONIA in the sterling exchange traded derivatives market by June 17, 2021. The statements are available **here** and **here**.
- BoE released a transcript of the speech "Descending safely: Life after LIBOR" by the Governor of Bank of England, Andrew Bailey. The transcript is available **here**.
- "BoE warns over easy alternatives to LIBOR". The article is available **here**.
- "FCA unfazed by 'inflated' sterling LIBOR swaps trading". The article is available **here**.
- FCA issued a consultation paper on the proposed use of powers over use of critical benchmarks. The consultation is available **here**.

European Union

- The working group on euro risk-free rates published recommendations on EURIBOR fallback trigger events and €STR-based EURIBOR fallback rates. The report is available **here** and press release is available **here**.

Asia

- "Singapore Small and Medium Sized Enterprise (SME) adoption of The Singapore Overnight Rate Average (SORA)-based products grows". The article is available **here**.
- Bloomberg hosted a webinar titled "LIBOR Transition webinar: Tough Legacy Bonds in Asia Pacific". The webinar is available **here**.
- "Asia readiness for the end of LIBOR". 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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