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Deloitte LIBOR Transition Newsletter
May 2021
Regulatory Updates: 04.01.21 – 05.06.21
Market Updates: 04.01.21 – 05.19.21

Deloitte[i] US LIBOR Transition Newsletter

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

Executive Summary

The Alternative Reference Rates Committee (ARRC) announced a set of ruling principles it will use to guide the decision making related to recommending a Secured Overnight Financing Rate (SOFR) term rate. Upholding its commitment to communicating the conditions the ARRC considers mandatory for a recommended SOFR term rate, the ARRC has provided the following three ruling principles: (1) a SOFR term rate will need to meet the ARRC's criteria for alternative reference rates, (as does SOFR itself); (2) the recommended SOFR term rate will be rooted in a robust and sustainable base of derivatives transactions over time; and (3) will have a limited scope of use so as encourage a proportional derivatives market depth.

To facilitate the progress of the LIBOR transition and to provide a clear guidance to develop a term SOFR rate, the ARRC has identified three 'clear and achievable' market indicators. These market indicators are: (1) continued growth in overnight SOFR-linked derivative volumes; (2) visible progress to deepen SOFR derivatives liquidity; and (3) visible growth in cash products, including loans, linked to averages of SOFR, either in advance or in arrears. The progress of liquidity of SOFR derivatives plans to be measured by: (a) offering electronic market-making and execution in SOFR swaps and swap spreads; (b) changing the market convention for quoting USD derivative contracts from LIBOR to SOFR; and (c) making markets in SOFR-linked interest rate volatility products (including swaptions, caps and floors).

The Chicago Mercantile Exchange (CME) announced in late April 2021 that it would begin publishing CME Term SOFR rates for 1, 3, and 6-month tenors. The CME noted that these rates are based on deep and liquid underlying SOFR futures, making these robust and sustainable measures of forward-looking SOFR rates. This highlight is meant to reinforce the fact that the CME Term SOFR rates are aligned with the ARRC's second governing principle for selecting a SOFR term rate recommendation. The rates plan to be available for license, free of charge, for cash market transactions initially until June 30, 2023, intended to comply with the ARRC's third governing principle for limited scope of use.

The Securities Industry and Financial Markets Association (SIFMA) raised concerns in a press release regarding the transition of existing LIBOR-referencing financial contracts which have no practical means to be amended away from their current LIBOR reference rate. As such, they have explicitly expressed support for a federal legislative solution which could facilitate the transition of this stock of contracts, in line with the similar legislation recently passed in the state of New York (NYS). Lawmakers from across the aisle as well as senior regulatory officials have shown support for this federal legislative solution as it would be helpful in addressing the systemic risk associated with a LIBOR-end date without a clear path for some legacy contracts.

SOFR is the ARRC's recommended replacement for LIBOR, but the official sector has been clear that it is open to innovation in reference rates as long as they follow the International Organization of Securities Commissions (IOSCO) principles and are "fit for purpose". Several alternatives have been developed which address one of the frequent concerns around SOFR's replacement of LIBOR, the lack of a bank credit component that reflects the bank's marginal cost of funds. Banks have appreciated this component of LIBOR as it allows them to better manage liquidity outflows during times of market stress. Two credit-sensitive rates (CSR's) that stand out are: 1) Bloomberg Short-Term Bank Yield Index (BSBY), based on actual transactions and executable quotes, and 2) Ameribor, calculated from actual borrowing costs between small and mid-size banks.

Our Perspective

Key Principles and Market Indicators for a Forward-Looking SOFR Term Rate
As the ARRC continues its selection process for a recommended term SOFR rate, it continues to encourage market participants to leverage current SOFR conventions already available. The ARRC does, however, recognize that a forward-looking SOFR term rate is highly anticipated by the industry as a tool to be utilized for a good portion of the transition away from LIBOR. Therefore, the ARRC has set out several activities intended to further build liquidity in the SOFR derivatives market which would promote robustness of any recommended term rate. The ARRC has clearly set out their guiding principles with regards to necessary conditions for a term rate recommendation in efforts to provide additional transparency with regards to associated timelines and milestones. Furthermore, the market indicators set out by ARRC provide clear and achievable measures that need to be achieved so that ARRC can recommend a SOFR term rate. As the timeline for recommending a SOFR-term rate is 'state-dependent' (not time-dependent), these indicators will encourage market participants to accelerate their adoption of SOFR derivatives, thereby achieving a term rate relatively early.

CME Group Announces Launch of CME Term SOFR Reference Rates
The CME believes their SOFR futures rates are compliant with the ARRC's and other regulatory bodies' guidelines for benchmark rates particularly because they are based on a deep and diverse pool of market participants. Per the CME article (**here**), SOFR futures averaged $232 billion in daily value and even reached a new record quarterly average daily volume of 112,000 contracts in the first quarter of 2021. This average daily volume record was set by an 82% increase since the previous year. The CME Term SOFR Rates are also aligned with UK Benchmark Regulations and the International Organization of Securities Commissions (IOSCO) guidelines for financial benchmark rates.

Potential LIBOR Federal Legislative Relief
The proposed federal legislation to address legacy LIBOR-linked contracts is aimed at achieving several goals for LIBOR end-users. Primarily, legislators would like to promote certainty, fairness, and equality of outcomes, the avoidance of years of costly court battles, and the preservation of liquidity and market resilience. The legacy contracts this legislation aims to address are typically executed prior to the implementation of comprehensive fallback language which contemplates the permanent cessation of LIBOR. As estimated by the ARRC, some $74 trillion in LIBOR exposure plan to extend beyond the June 2023 final cessation dates, with a large majority attributed to swaps, futures, and related transactions which can prove specifically troublesome when trying to amend. A federal legislation would save the industry countless hours of costly legal fees and reduce overall instability during the anticipated transition period.

Current Market Developments for Credit Sensitive Alternative Rates

When the ARRC decided against recommending a term SOFR component, many institutions started looking more closely at CSRs more closely as they contained both the credit component that they appreciated from LIBOR as well as its forward term structure. Both Bloomberg’s BSBY rate and AFX’s Ameribor have seen increased interest and certain institutions have originated loans and derivatives using these two rates as their base. While the production of a term SOFR rate may change this dynamic as it creates a forward-looking structure, it seems that many banks will prefer to maintain the credit sensitive element that they find important to have in their lending books. This space will bear monitoring over the coming months as market standards begin to develop

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 April 1, 2021 until April 30, 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:

NYS Legislation and ARRC Waterfall Conventions
- The ARRC's recommendations mirror fallback consultations for different products. Recommended first would be a term rate of similar maturity. In the event, that does not exist, the ARRC would the recommend some form of a compound SOFR in advance or in arrears. These recommendations will be compiled and shared by the ARRC at some point in the coming months.

Supervisory Guidance SR 20-27 Letter
- The supervisory guidance letter contains carve-outs for specific transactions. These include transactions executed for (1) purposes of required participation of a central party option in case of a member party default, (2) market making in support of client activity related to USD LIBOR transactions executed prior to January 1, 2022, (3) transactions that reduce a hedge for banks or clients of banks with USD LIBOR exposures on contracts entered into prior to 1/1/22, or (4) for novation of USD LIBOR contracts executed before 1/1/22.

SOFR Term Rate and Curve
- The ARRC set a goal for a recommended term SOFR rate in June 2021, dependent on market conditions and liquidity. It is unlikely the ARRC will meet the June 2021 goal, but the ARRC is still working for a goal of the end of 2021 so long as the conditions are met. Even if a SOFR term rate is no published, however, a SOFR curve will be available – CME and London Clearinghouse (LCH) have a SOFR curve which is used to value trillions of dollars of instruments. The term rate is just a benchmark to be written into contracts, but a SOFR curve has been available for some time now. This information can be sourced from Reuters or Bloomberg.

NYS Legislative Solution Coverage
- The NYS legislation only covers contracts that explicitly refer to LIBOR and not contracts that refer to the ICE USD LIBOR swap rate or any other contracts in which LIBOR is not the benchmark rate.

CME Term SOFR Rate
- The CME Term SOFR Rates are aligned with the ARRC principles although the ARRC has not yet recommended the CME or any other term rate (1,3,6-month). The CME restriction of their term rate to cash products only is in line with prior comments and suggestions from the ARRC on scope of use and is helpful for the market. The UK currently has multiple term rates for Sterling Overnight Index Average (SONIA) and it is possible a similar approach will be adopted in the US. There will, however, be only one ARRC recommended term rate.

SOFR vs. SIFMA Calendars
- The FRB has discussed releasing a calendar for when SOFR rates will and will not be published, following the Good Friday discrepancy this year. SOFR typically follows the SIFMA calendar, however this year SIFMA declared Good Friday was a trading day as an employment report was due on that day, but the market was effectively closed (including repo markets). The International Swaps and Derivatives Association (ISDA) has released guidance on how to handle these infrequent situations.

SOFR Spread Use
- The SOFR spread is used for fallback loans that move from LIBOR to SOFR and is not intended for newly issued loans. The margin for new loans should be set by the market.

Regulatory Highlights

- The ARRC announced a set of ruling principles it will use to guide decision making as it looks to recommend a SOFR. The key principles are available **here**.
- The ARRC identified market indicators to support a recommendation of a forward-looking SOFR term rate. The market indicators are available **here.**
- The CME announced that they would begin publishing CME Term SOFR rates for 1-month, 3-month, and 6-month tenors. The article is available **here.**
- The SIFMA raised concerns in a press release regarding the transition of existing LIBOR-referencing financial contracts being amended away from their current LIBOR reference rate. The article is available **here**.
- Bloomberg published an article titled "The Race for LIBOR's Replacement is Too Close to Call". The article is available **here**.
- The Wall Street Journal published an article titled "LIBOR Replacement Race Heats Up". The article is available **here**.

ARRC Updates

- The ARRC published their recommended approach to using SOFR in new issuances of a variety of securitized products. The white paper is available **here**.
- The ARRC endorsed the decision to sign bill into NYS law. The statement is available **here**.
- The ARRC released an update to the March 2021 progress report on the transition from USD LIBOR. The report is available **here**.
- The ARRC held the second event in its series of webinars titled: "The SOFR Symposium: The Final Year" on May 11, 2021. The webinar registration and information is available **here**.
- The ARRC published its February-March 2021 newsletter. The newsletter is available **here**.

ISDA Updates

- ISDA released a press briefing on end of LIBOR and what it means for the derivatives market. The webcast is available **here**.
- ISDA released the ISDA 2021 definitions working group call recordings through April 6, 2021. The recordings are available **here**.
- ISDA hosted a webinar titled "ISDA: Implementation of the 2021 ISDA Interest Rate Derivatives Definitions". The video is available **here**.
- ISDA hosted a webinar titled "ISDA: Introduction to the 2021 ISDA Interest Rate Derivatives Definitions". The video is available **here**.
- ISDA published an article titled "No delay in US Dollar LIBOR". The article is available **here**.
- ISDA published the ISDA-Clarus Risk Free Rate (RFR) Adoption Indicator for March 2021. The indicator is available **here**.
- ISDA published the ISDA SwapsInfo Q1 2021 review summary. The summary is available **here**.

Intercontinental Exchange (ICE)/CME Updates

- Bloomberg published an article titled "CME Group Announces Launch of CME Term SOFR Reference Rates". The article is available **here**.
- ICE published its Interest Rates Report for March 2021. The report is available **here**.
- CME Group published its CME April 2021 Rates Recap report. The report is available **here**.
- CME Group published the CME IBOR conversion proposal for cleared swaps. The proposal is available **here**.

Other News/ Useful Reading

- Assembly Bill A164B for the LIBOR legislative solution is NY state law. A summary of the bill and the legislative text are available **here**.
- The Committee on Financial Services (FSC) majority staff issued a joint trade letter to US House Committee on Financial Services in support of legislative solution for the end of LIBOR and virtual hearing. The letter is available **here**.
- "Market dispels fears over USD Libor cross-currency swap shift". The article is available **here**.
- "US markets fret over 'unrepresentative' fallbacks". The article is available **here**.
- "ISDA preps swaps blueprint for new Bloomberg rates benchmark". The article is available **here**.
- "Understanding the LIBOR Transition special report". The article is available **here**.
- "The final countdown: Are businesses prepared for the LIBOR transition?". The article is available **here**.
- "Keep calm and transfer: considerations ahead of the LIBOR index transfer". The article is available **here**.
- "Fed group lays out path for securitized issuers to ditch LIBOR". The article is available **here**.
- "The end of LIBOR – considerations for corporates". The article is available **here**.
- "SOFR bond issuance up despite shortcomings". The article is available **here**.

Market Updates

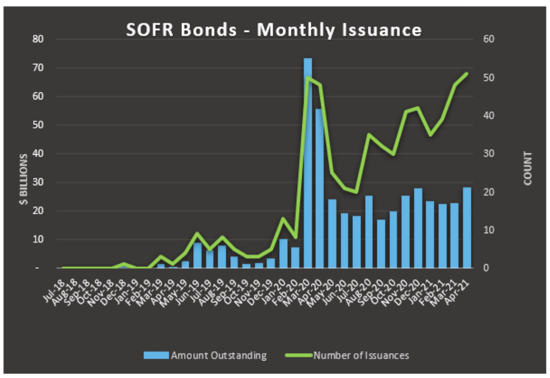
** Please note that the change in numbers and trend lines for bonds compared to figures in previous newsletters is due to change in the data source. Issuance data for bonds has been sourced from Reuters.*

Increase in Debt Issuance Referenced to SOFR

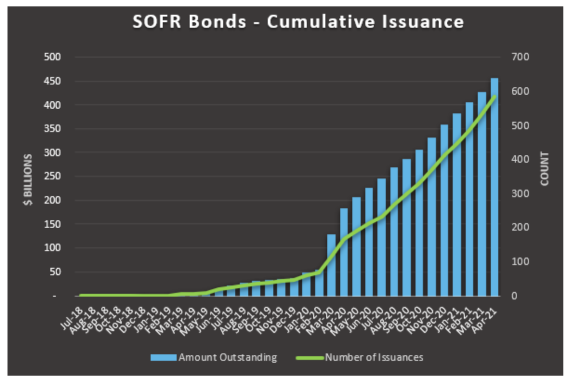
The issuance of SOFR referenced debt increased in April 2021 compared to issuance in March 2021. The issuance size was $27.98 billion in April 2021, which increased from $22.53 billion in March 2021. The graphs below represent data through April 30, 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently $461.32 billion with 605 bonds through May 19, 2021. There were 51 new issuances in April 2021 compared to 48 in March 2021 and 39 in February 2021.

In April 2021, federal agencies issued 17 SOFR referenced Floating Rate Notes (FRNs) worth $12.68 billion. There were 34 issuances from other institutions which contributed $15.3 billion to the outstanding amount of SOFR referenced debt.



Source: Reuters, compiled by Deloitte
**Data as of April 30, 2021*

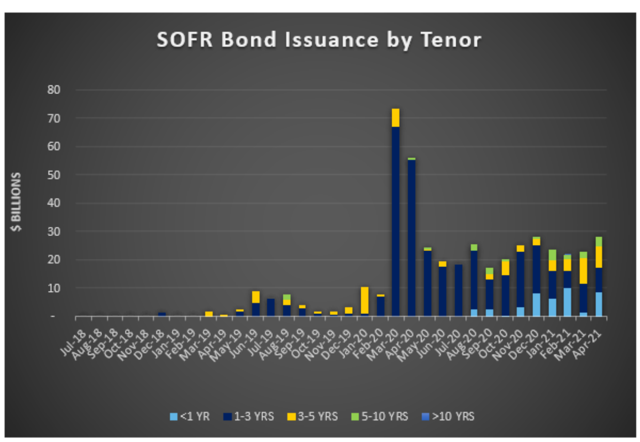


Source: Reuters, compiled by Deloitte
**Data as of April 30, 2021*

Increase in Longer Dated Debt Issuance (maturity ≥ 5 years) Referenced to SOFR

SOFR debt issuances with a maturity greater than or equal to five years increased in April 2021 compared to March 2021. During April 2021, there were 11 bonds issued which have a maturity between five and ten years. There were no issuances during April 2021 that have a maturity greater than or equal to ten years, as was the case for March 2021.

There were 36 issuances of SOFR bonds outstanding worth $18.18 billion, with a maturity greater than or equal to five years, through May 19, 2021 including 3 issuances worth $673.02 million with a term greater than or equal to 10 years.



Source: Reuters, compiled by Deloitte
**Data as of April 30, 2021*

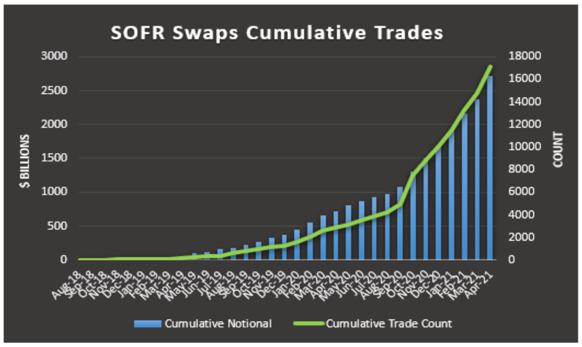
Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

- The cumulative traded notional amount for SOFR based interest rate and basis swaps totaled $2,717.6 billion through April 30, 2021.
- For the month of April 2021, the notional volume of SOFR-based interest rate and basis swaps totaled $345.8 billion compared to $206.9 billion in March 2021, and $267.4 billion in February 2021.

SOFR Futures

- According to data available on CME, for April 2021, SOFR futures average daily volume reached 111.5K contracts/ day. The data is available **here**.
- The month-end open interest for SOFR 1 and 3 month futures as of April 2021 was ~802K contracts.



Source: http://swapsinfo.org/, compiled by Deloitte
**Data as of Apr 30, 2021*

Source: CME Group
**Data as of Apr 30, 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 April 30, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US $ Billions)	Bonds Cumulative issuance amount (US $ Billions)
SONIA	37,668.7	115.3
SARON	68.7	NA
TONA	698.0	NA
€STR	172.3	5.9

Source: Reuters, http://swapsinfo.org/, compiled by Deloitte
Data as of April 30, 2021

Global Highlights

United Kingdom

- Bank of England (BoE)'s Working Group on Sterling Risk-Free Reference Rates (RFR WG) published the March 2021 newsletter. The newsletter is available **here**.
- BoE's RFR WG published the April 2021 newsletter. The newsletter is available **here**.
- "Financial Times Stock Exchange Group (FTSE) Russell Indicative Term SONIA Reference Rates will be discontinued effective June 4, 2021". The article is available **here**.
- "The Financial Conduct Authority (FCA) could get legal with firms that continue to use US Dollar Libor in new contracts after the end of this year". The article is available **here**.
- "UK's largest housing association agrees £100m sustainable SONIA linked loan". The article is available **here**.
- "The transition away from Sterling LIBOR". The article is available **here**.

European Union

- The European Central Bank (ECB) published the summary of the fifth meeting of the €STR oversight committee. The summary is available **here**.
- "Traders see easy switch off LIBOR in Swiss market at year-end". The article is available **here**.
- "LIBOR proposal offers partial relief on Polish banks' foreign currency loans". The article is available **here**.
- "The End of LIBOR: Transitioning to an alternative interest rate calculation for mortgages, student loans, business borrowing, and other financial products". The article is available **here**.

Asia

- Steering Committee for Singapore Dollar Swap Offer Rate (SOR) & Singapore Interbank Offered Rate (SIBOR) Transition to SORA (SC-STS) report on timelines to cease issuance of SOR & SIBOR products. The report is available **here** and the press release is available **here**.
- "Singapore says no new SOR swaps post September". The article is available **here**.
- "A $27 trillion challenge looms as Yen Libor shift deadline nears". The article is available **here**.
- "Dealers applaud proposal to halt yen Libor swaps after Q3." The article is available **here**.
- "Asia's first cross currency basis swap references Loan Prime Rate and LIBOR." The article is available **here**.
- "Standard Chartered completes novel USD/CNH swap." The article is available **here**.
- "LIBOR Shift Advances in Asia as New Swap Traded in Hong Kong." The article is available **here**.
- "Singapore passes LIBOR milestone with $128 Billion at stake." 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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