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Deloitte LIBOR Transition Newsletter
October 2021
Regulatory Updates: 09.01.21 – 10.06.21
Market Updates: 09.01.21 – 10.20.21

Deloitte[i] US LIBOR Transition Newsletter

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

Executive Summary

On September 29, 2021, the Intercontinental Exchange, Inc. (ICE) noted that the UK's Financial Conduct Authority (FCA) will compel ICE Benchmark Administration Limited (IBA) to publish the 1-, 3- and 6-month sterling (GBP) and Japanese yen (JPY) "synthetic" London Interbank Offered Rate (LIBOR) methodology for the duration of 2022. The decision comes after recent consultation to help ensure a smooth transition from the 1-, 3-, and 6-month GBP and JPY LIBOR rates, which plan to be accomplished under a changed methodology. The new methodology plans to involve the relevant ICE Term Sterling Overnight Index Average (SONIA) Reference Rate provided by IBA and the Tokyo Term Risk Free Rates (TORF) provided by QUICK Benchmarks Inc. (adjusted to be on a 360-day count basis) plus the respective International Swaps and Derivatives Association (ISDA) fixed spread adjustment for each of the six settings. The first set of the six "synthetic" rates are targeted for January 4, 2022. Per the FCA, users of LIBOR should not rely on the new "synthetic" rates and should continue to focus on active transition.

On October 6, 2021, the ARRC released an overview of its latest recommendations for spread adjusted fallbacks for contracts referencing USD LIBOR. The ARRC's spread recommendation for fallback provisions are static, much like ISDA's recommendation for fallback spreads. The spreads are fixed at a point at a trigger event, in this case March 5, 2021 when IBA stated it would cease all 35 LIBOR settings on their respective cessation dates. Dynamic spreads were not considered as this would rely on the same wholesale unsecured funding markets that LIBOR relies on and are currently very thin. ARRC's first consultation of market participants noted that its recommended fallback spread adjustment methodology would be based on a five-year lookback period, calculated as the difference between USD LIBOR and SOFR, which aligns with ISDA's recommendation. The ARRC formed a steering committee to help identify an administrator to publish the recommended spread-adjusted rates and the steering committee evaluated five firm proposals and in March 2021 announced its decision to select Refinitiv. In August 2021, Refinitiv has released "beta" versions of its spreads.

The August – September 2021 edition of the Alternative Reference Rates Committee's (ARRC's) newsletter highlighted the importance of transition from different industry groups including the ARRC itself, the Office of the Comptroller of the Currency (OCC) and the Financial Industry Regulatory Authority (FINRA). ARRC Chairman Tom Wipf wrote an op-ed in *The Banker*, titled "Market participants must act now as US LIBOR ends". The article highlights that market participants should have all the necessary tools to make transition from LIBOR a safe and smooth not only for their institution, but also for the financial markets overall. The newsletter highlights the congressional testimony published by the OCC by Acting Comptroller Michael Hsu. The publication outlined the OCC's support for Secured Overnight Financing Rate (SOFR) to replace U.S. Dollar (USD) LIBOR and the transition expectations for supervised banks. If banks choose other replacement rates besides SOFR, they are encouraged to fully analyze the appropriateness as OCC examiners will be evaluating the robustness of the rates selected. The newsletter also highlights regulatory notice 20-26, issued by FINRA, which reminded firms to ensure they are adequately prepared for the upcoming LIBOR transition. FINRA also provided considerations for market participants to self-evaluate their current LIBOR transition preparedness.

Our Perspective

FCA to Compel IBA to Publish 1-, 3- & 6-Month GBP and JPY "Synthetic" LIBOR

The FCA has compelled the IBA to supply "synthetic" LIBOR for GBP and JPY to help alleviate transition of these six LIBOR settings into 2022. By providing a rate of last resort (synthetic LIBOR), uncertainty surrounding legacy contracts post LIBOR cessation can be reduced for contracts that reference LIBOR, but do not include viable fallback language in the event of LIBOR's cessation. While the FCA is compelling the IBA to provide "synthetic" rates, market participants should be careful relying on these new rates and should continue to press forward on active LIBOR transition in efforts to retain both economic and functional control over their contracts.

ARRC Spread-adjusted Fallback Recommendations

The latest summary provides market participants a central location to review the ARRC's recommendations over time regarding the spread-adjusted fallbacks. This gives market participants all the tools they require to make the transition away from USD LIBOR to SOFR. As the industry closes in on the final inning, market participants will need to start using SOFR in new contracts and implementing the ARRC's fallback recommendations now before it is too late.

US Market LIBOR Transition Push

As the third quarter ends, many US regulatory authorities are urging market participants to continue to drive their respective LIBOR transition plans with many highlighting their favor for the ARRC recommended SOFR replacement for USD LIBOR. As the final stretch approaches, institutions should plan to not issue any new LIBOR contracts, update legacy contracts where possible by leveraging fallback language or renegotiating contracts and help support federal legislation meant to provide a critical safe harbor for contracts that do not contain appropriate fallbacks.

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 September 1, 2021 until September 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:

End User Categorization and Term-SOFR for Hedging
- The end user is any direct counterparty to Term SOFR cash product (borrower, non-financial corporate, bank or multilateral development bank). The ARRC, in line with Financial Stability Board (FSB) statement, has stated that it believes that use of term SOFR in derivatives market should be very limited (e.g. for hedging a term SOFR cash product). Therefore, the ARRC recommendation do not cover any party issuing a fixed-rate debt instrument. To hedge such an instrument, the bank can make term-SOFR loan, and swap that with overnight SOFR bond or use any other approach from ARRC's recommendation.

Legacy LIBOR in Secondary Syndicated Market
- The supervisory guidance is about new use of new issuance. It has no recommendations about purchase or selling of legacy LIBOR instruments that is created before end of 2021. For legacy loan, the terms of LIBOR can continue next year, and they can be bought or sold. Per guidance, a firm regulated by supervisory bodies cannot trade new LIBOR derivative instruments starting next year, however, they can do so if they want to hedge existing legacy LIBOR exposure. These specific guidance are about derivatives for the purpose of hedging. If a client has legacy LIBOR deposit account, whose deposit value can go up and down, the firms are encouraged to speak to their examination team.

Operational Considerations for Cash Products
- The ARRC's Operations and Infrastructure Working Group is working on the considerations for cash products. A lot of stakeholders are focused on new use, and not much on legacy products. The ARRC is rearranging some of the chairs of the group, so as to bring in more institutions that deal with such operations. This way they can gain traction from the stakeholders and discuss more on legacy products.

Changes to Expect at Cessation for Non-Linear Products
- In some non-linear products, one wouldn't just scrap LIBOR, but would also need to swap ICE USD LIBOR swap. That is something that the ARRC and the UK Working group have worked on to determine what kind of spread adjustment one would like to have. Cash compensation hasn't worked in most cases (e.g. price alignment amount (PAA) discounting for London Clearing House (LCH) as it's hard to get collective action around cash compensation. The ARRC encourages firms to convert early, at an appropriate price.

Lending Institutions and New LIBOR Issuance
- There should be no new LIBOR lending after the end of this year. Lending market is still building, and there have been some nice SOFR deals. Which means the firms have 3 months to go from nearly all new LIBOR lending to no-new LIBOR lending. Banks are focusing on planning when to move, and how to move. Internally they may choose to make no new LIBOR loans, take into account the exposure, and decide the timelines and procedure on how to go to no-new LIBOR lending. Another consideration is around multi-currency lending where multiple jurisdictions are involved, and, where no term rate is involved. Here, many firms are choosing between simple Risk-Free Reference Rates (RFR)'s v/s compounded RFR's and determining how they can offer syndicated loans.

Optionality to ARRC's Recommended Rate
- Under NYS legislation, there are two scenarios: 1) The contract either does not contain fallback language or refers to a poll or prior published value or LIBOR. In this situation, the legislation names the replacement rate. 2) There is fallback language in the contract that allows a party the discretion to name a new rate. In this situation, there is as safe harbor provision if the party selects an ARRC recommended rate. In the first scenario, there is not a choice as this hardwired component points to a single rate only. The second scenario may allow the use of a compound or term since the ARRC is leaning towards allowing the discretion of the type of SOFR which would be in the spirit of the fallback language of allowing a party the discretion to select a rate.

Regulatory Highlights

- On September 29, 2021, The ICE noted that the UK FCA will compel IBA to publish the 1-, 3- and 6-month sterling and Japanese yen "synthetic" LIBOR methodology for the duration of 2022. The article is available **here**.
- On October 6, 2021, the ARRC released an overview of its latest recommendations for spread adjusted fallbacks for contracts referencing U.S. dollar LIBOR. The summary of ARRC's fallback recommendations is available **here**.
- The ARRC released its August-September 2021 newsletter. The newsletter is available **here**.

ARRC Updates

- The ARRC hosted the fifth SOFR Symposium on September 20, 2021. The webinar is available **here** and the prior symposiums are available **here**.
- The US Securities and Exchange Commission (SEC) published the remarks by then Chair before the ARRC's SOFR Symposium. The transcript is available **here**.
- The ARRC published an article titled: "Transitioning away from LIBOR: Understanding SOFR's strengths and considering the path forward". The article is available **here**.

International Swaps and Derivatives Association (ISDA) Updates

- ISDA expanded its SwapsInfo analysis to include interest rate derivatives activity reported in Europe. The report is available **here**.
- ISDA published their response to FRB and FCA letters relating to fallbacks for credit-sensitive rates. The correspondences are available **here**.
- ISDA published the ISDA-Clarus RFR adoption indicator for August. The report is available **here**.

IOSCO

- The International Organization of Securities Commissions (IOSCO) issued a statement on credit-sensitive rates. The statement is available **here**.
- "IOSCO steps up scrutiny of credit-sensitive rates". The article is available **here**.
- "IOSCO on Compliance of Credit-Sensitive Rate with Benchmark Principles". The article is available **here**.
- "SOFR Academy welcomes the IOSCO's statement on credit-sensitive rates". The article is available **here**.

Other News/ Useful Reading

- "So near, SOFR: The race to find a LIBOR alternative". The article is available **here**.
- "LIBOR transition stokes sales of risky corporate debt". The article is available **here**.
- "LIBOR replacement reaches Wall Street's leveraged loan market". The article is available **here**.
- "LIBOR transition stokes sales of risky corporate debt". The article is available **here**.
- "LIBOR alternative is winning over derivatives traders". The article is available **here**.
- "Loan Syndications and Trading Association (LSTA) – In search of 'fair' spread adjustments for new SOFR loans". The article is available **here**.
- "A regulatory push is key for a post-LIBOR world". The article is available **here**.
- "SOFR in arrears or term? You decide". The article is available **here**.
- "Bloomberg webinar on LIBOR Transition Series: Derivatives Pricing & Analytics". The webinar is available **here**.
- "Q&A with ARRC's Tom Wipf - The shift to term SOFR". The article is available **here**.
- "SEC's Gensler wants to ensure LIBOR replacements are 'clothed'". The article is available **here**.
- "LIBOR replacement reaches Wall Street's leveraged loan market". The article is available **here**.
- "Bloomberg Short Term Bank Yield Index (BSBY) swap fallbacks too flimsy for UK Benchmarks Regulation (BMR) – FCA". The article is available **here**.
- "Traders take up derivatives tied to LIBOR replacement". The article is available **here**.
- "Cross-currency swaps set to ditch LIBOR in 'RFR first' drive". The article is available **here**.
- "Derivatives set for $15 trillion switch in LIBOR test run". The article is available **here**.
- "Bloomberg webinar: Introducing the BSBY". The webinar is available **here**.

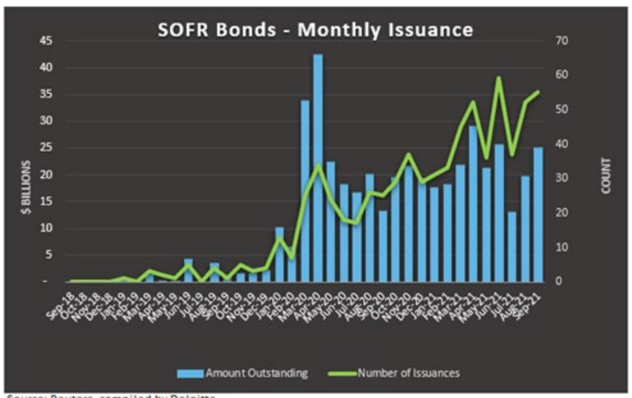
Market Updates

Increase in Debt Issuance Referenced to SOFR

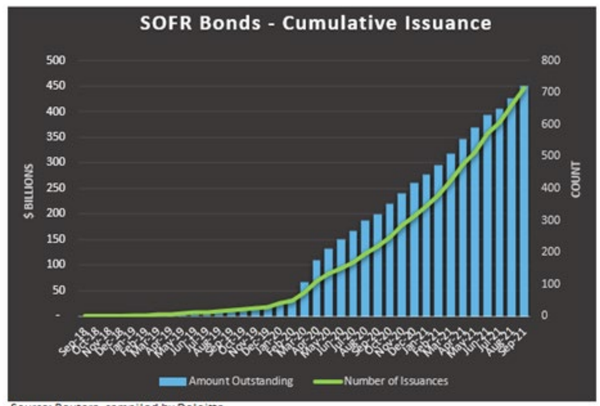
The issuance of SOFR referenced debt increased in September 2021 compared to issuance in August 2021. The issuance size was $25 billion in September 2021, which increased from $19.65 billion in August 2021. The graphs below represent data through September 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently $451.82 billion with 735 bonds through October 20, 2021. There were 55 new issuances in September 2021 compared to 52 in August 2021 and 37 in July 2021.

In September 2021, federal agencies issued 21 SOFR referenced floating rate notes (FRN)'s worth $9.07 billion. There were 34 issuances from other institutions which contributed $15.94 billion to the outstanding amount of SOFR referenced debt.



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

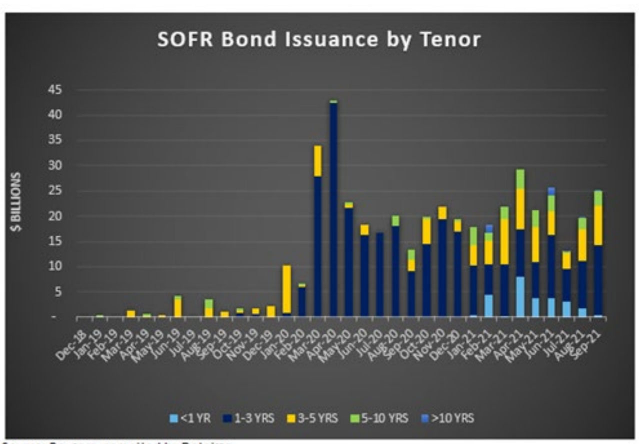


Source: Reuters, compiled by Deloitte
Data as of September 30, 2021

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 September 2021 compared to August 2021. During September 2021, there were 11 bonds issued which have a maturity between five and 10 years. There were two issuances during September 2021 that had a maturity greater than or equal to 10 years, as compared to one such issuance with a maturity greater than or equal to 10 years for August 2021.

There were 95 issuances of SOFR bonds outstanding worth $31.51 billion, with a maturity greater than or equal to five years, through October 20, 2021 including 10 issuances worth $3.34 billion with a term greater than or equal to 10 years.



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

Cumulative SOFR Interest Rate Derivatives

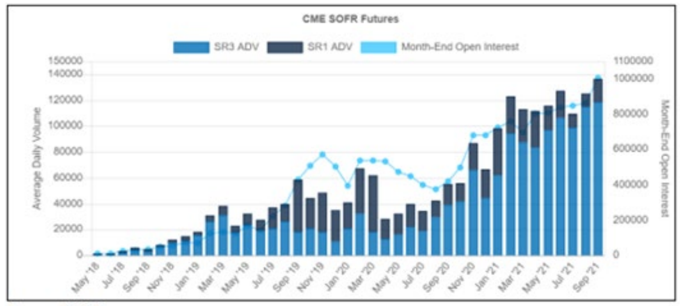
SOFR Swaps

- The cumulative outstanding notional amount for SOFR based interest rate and basis swaps totaled $5,520.50 billion through September 30, 2021.
- For the month of September 2021, the notional volume of SOFR-based interest rate and basis swaps totaled $1,135.90 billion compared to $641.6 billion in August 2021 and $443 billion in July 2021.

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

SOFR Futures

- According to data available on CME, for September 2021, SOFR futures (including both 1-month and 3-month futures) average daily volume reached 136K contracts/ day. The data is available **here**.
- The month-end open interest for SOFR 1-month and 3-month futures as of September 2021 was ~1M contracts.



Source: CME Group
Data as of September 30, 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 September 30, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US $ Billions)	Bonds Cumulative issuance amount (US $ Billions)
SONIA	44,517.1	140.5
SARON	162.2	NA
TONAR	943.9	NA
€STR	406.2	5.7

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

Global Highlights

United Kingdom

- The Bank of England (BoE) to modify clearing rules ahead of LIBOR transition. The article is available **here**.
- "Scenario Analysis: Potential effects of LIBOR replacement on U.K. Residential Mortgage Backed Securities (RMBS) ratings." The article is available **here**.
- "LIBOR transition: New UK "safe harbour" Bill introduced into Parliament". The article is available **here** and Critical Benchmarks (References and Administrators' Liability) Bill is available **here**.
- "UK watchdog sets out plans for a 'synthetic' LIBOR rate". The article is available **here**.
- "SONIA/SOFR swaps jump ahead of 'RFR first' initiative". The article is available **here**.

European Union

- The Euro RFR Working Group Chairman wrote to the European Commission regarding consultation on the draft Implementing Act for Euro Overnight Index Average (EONIA) transition. The correspondence is available **here**.
- The European Securities and Markets Authority (ESMA) published a summary of their July 2021 meeting. The report is available **here**.
- The ESMA published the final report for guidelines on methodology, oversight function and record keeping under the Benchmarks Regulation. The report is available **here**.
- "Poland presses the European Union (EU) for quick fix to expiring Franc LIBOR rates". The article is available **here**.
- "How to transition away from LIBOR: An assessment from a Transfer Pricing (TP) perspective". The article is available **here**.
- "Swiss watchdog Financial Markets Supervisory Authority (FINMA): banks' syndicated loans falling behind LIBOR transition". The article is available **here**.

Asia

- The Association of Banks in Singapore (ABS) published the Singapore Overnight Rate Average (SORA) calculation methodology for retail spread adjustment. The report is available **here**.
- The Central Bank of the Philippines (BSP) has instructed banks to proactively transition from LIBOR. The article is available **here**.
- "What you need to know about SORA, the new interest rate benchmark in Singapore". The article is available **here**.
- "Thailand: The move from LIBOR and transfer pricing (TP) – a Thai perspective". 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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