This past month, there has been a heightened focus on pre-cessation triggers, progress made towards calculating fallback adjustments and proposed new guidance related to tax consequences of the transition from LIBOR to alternative reference rates.

ISDA published the results to the consultation on pre-cessation issues for LIBOR which was also highlighted during the ARRC’s office hours Q&A with David Bowman of the Federal Reserve. ISDA also published supplemental consultation on spread and term adjustments for fallbacks in derivatives and announced that Bloomberg Index Services Limited (BISL) will be calculating and publishing adjustments related to fallbacks. Under proposed new guidance, the US Treasury Department will not consider changes to existing financial instruments that switch from LIBOR to another alternative rate as a “taxable event” under IRS rules.

SOFR has been continually gaining traction this month as also shown in the previous few months. There has been an increase in the SOFR referenced cash issuances and derivatives as well as an increase in longer-term maturity bonds.
ARRC Office Hours Q&A with David Bowman (Federal Reserve Board)
Select questions are from August 2 2019 until August 30 2019. These questions and answers do not represent the view of the Federal Reserve, but are the personal views of David Bowman outside of his official capacity. Weekly office hour information can be found here. Below are some of the specific topics discussed:

**Pre-Cessation Trigger**
- The FSB encouraged ISDA to have a pre-cessation trigger consultation and is in favor of its addition. The addition of pre-cessation trigger #5 “a public statement or publication of information by the regulatory supervisor for the administrator of the Benchmark announcing that the Benchmark is no longer representative” may likely help prevent a Zombie LIBOR. CME/LCH have made it clear that an FCA statement to that effect may likely trigger the transition regardless of what ISDA does. If ISDA does not include this trigger, the risk is if FCA acknowledges LIBOR to be non-representative and LIBOR continues to be published clear derivatives may likely be treated one way and uncleared another.

**Guidance for Cash Products**
- The ARRC will release guidance for cash products as it relates to terms/conditions such as look back/lock out to create an aligned approach across the industry where there is consensus.

**CME’s Cash Adjustment**
- CME recently published note following up on their big bang approach and having a mechanism for a cash adjustment as part of a compensation scheme to adjust for potential changes in value/risk in the move from one discounting environment to another. Both ARRC and ISDA will have a spread adjustment instead of a cash adjustment. This mechanism is their solution to decrease value transfer between the two parties.

**Fallback Language for FRNs**
- In the fallback language for FRNs, changing the Designee language to a calculation agent, independent advisor or someone else would not be inconsistent with the fallback language. Most of the fallback decisions are hardwired so a Designee may likely have mostly minor conforming decisions in their discretion. The ARRC also anticipates that many of the conforming changes will be resolved through market conventions over time. At the final waterfall stage for spread/rate it does allow the Designee to make a decision, but this option can be removed.

**Fallback Language for Bilateral Loans and Syndicated Loans**
- There is purposely a difference in the ARRC recommended fallback language for bilateral loans and syndicated loans due to the sheer number of bilateral loans that some lenders have and concerns about the operational feasibility of transition language. The recommend fallback language for bilateral loans has bracketed language to put in as an option that allows for negative consent on the part of the borrower. However, for syndicated loans, there are certain provisions the borrower/borrower’s agent can propose such as early opt-in and the majority of lenders have the right to object.

**ARRC Working Group**
- Released Matrix and Comparison Chart on SOFR FRN Conventions
  - The ARRC released a Matrix and Comparison Chart on SOFR FRN Conventions to assist in using compound interest in arrears with a lookback/lock out/payment delay period and the addition of margin at the end of the period here.
ISDA Updates

Preliminary Results on Consultations Released

- ISDA published the preliminary results of the Consultation on Pre-Cessation Issues for LIBOR and Certain Other Interbank Offered Rates (IBORs). The summary can be found [here](#).
  - The results of the consultation showed no clear majority for each of three categories concerning the addition of the a pre-cessation trigger related to “non-representativeness” for derivatives. The categories are:
    1. “Those who supported adding a pre-cessation trigger to the permanent cessation triggers in the “hard wired” amendment to the 2006 ISDA Definitions and related protocol.
    2. Those who supported use of the pre-cessation trigger provided that it was implemented with optionality and flexibility (or indicated that their support for the trigger depended on a number of factors).
    3. Those who opposed the pre-cessation trigger.”

- ISDA published the preliminary results of ISDA Supplemental Consultation on Spread and Term Adjustments for Fallbacks in Derivatives Referencing USD LIBOR, CDOR and HIBOR and Certain Aspects of Fallbacks for Derivatives Referencing SOR [here](#).
  - Based on the results, ISDA expects to proceed with developing fallbacks for inclusion in its standard definitions based on the compounded setting in arrears rate and the historical mean/median approach to the spread adjustment.

Bloomberg to Calculate Fallback Adjustments

- ISDA announced that Bloomberg Index Services Limited (BISL) has been selected to calculate and publish adjustments related to fallbacks that ISDA intends to implement for certain interest rate benchmarks in its 2006 ISDA Definitions. Press release can be found [here](#).

ICE Swap Rate Consultation & Other Workstreams

- ISDA is encouraging members to review and respond to the ICE Swap Rate consultation paper available [here](#). Responses are due by October 14, 2019.
- ISDA intends to publish a summary of key ISDA and other related interest rate reform workstreams on its website sometime in September 2019.

Other News / Useful Reading

- Treasury Proposes Guidance Clarifying Tax Consequences of Libor Transition [here](#).
- Bloomberg opinion article on the LIBOR transition [here](#).
- Bloomberg article on the End of LIBOR and Preparation for the End of a Crucial Benchmark can be found [here](#).
- Fitch Ratings warns that investor consent for the switch to a replacement rate represents a significant challenge for legacy RMBS deals [here](#).
Deloitte LIBOR Transition Newsletter

Increase in Cumulative Debt Issuance Referenced to SOFR
The SOFR debt market is slowly gaining traction with the issuance of the first SOFR referenced bond in July 2018. During 2018, most of the issuances were predominantly from government sponsored agencies. However, 2019 consisted of a greater participation from other financial institutions with both the issue size and number of issuances increasing steadily.

The cumulative issue size of SOFR bonds outstanding currently stands at $242.9 billion with 253 bonds (this excludes the matured bonds). The month of August 2019 saw the largest monthly issuance (roughly $55.6 billion) though September 2019 also has had a great start.

So far, federal agencies are leading from the front with $193.7 billion issuances and the largest private issuer consists of 33 bonds worth $11.2 billion.

Increase in Longer Dated Debt Issuance Referenced to SOFR
Majority of the SOFR bonds issued have a maturity less than 5 years. In September 2019, fixed-to-floating rate notes with an aggregate principal amount of $3.0 billion with a maturity of October 15, 2030 were issued. The notes bear interest at a fixed annual rate of 2.739% through October 15, 2029 and thereafter at three-month term SOFR plus 151 basis points. This is an important milestone as for SOFR to truly replace USD LIBOR as the benchmark rate, a reliable term structure of SOFR rates will be needed to build the forward curve.
Cumulative SOFR Interest Rate Derivatives

SOFR Swaps
- SOFR swaps have shown a steady increase; the notional volume of SOFR-based interest rate and basis swaps totaled $26.3 billion through September 20, 2019.
- At the end of August 2019, the notional volume of SOFR-based interest rate and basis swaps totaled $29.2 billion.

SOFR Futures
- Futures are a reliable indicator of market expectations of SOFR along the curve.
- Futures contracts have continued to increase since trading began in May 2018.
- CME Group and ICE both facilitate trading and clear SOFR futures. Currently, for 3-month SOFR futures open interest exists on contracts through September 2021.

Recent Spike in the Repo Market and the Impact on SOFR

SOFR rose to a record 5.25% on September 17, 2019, according to the Federal Reserve Bank of New York, which was mainly caused by an increase in borrowing rates for overnight repurchase agreements, also known as repos. Even with the recent volatility witnessed in the repo markets this past week, an average of SOFR, which is the rate that is used in the marketplace, remains very stable per ARRC. ARRC calculated that a 3-month compound average of SOFR only rose 2 basis points compared to rates last week whereas the three-month LIBOR rose 4 basis points. While SOFR and other overnight repo rates are more volatile than term LIBOR rates on a day-to-day basis, it is important to note that contracts referencing SOFR are based on averages of these daily rates. SOFR futures and OIS, and the many SOFR floating rate notes that have been issued all use either a compound or linear average of SOFR over a fixed period as the floating rate paid under the terms of the contract, not a single day’s realization of SOFR.
Global Highlights

United Kingdom
- The Bank of England published its July newsletter on August 8, 2019 and can be found here. The newsletter highlights and contains links to recent publications including the minutes from the May Working Group meeting, Discussion Paper on market conventions for SONIA, and market developments.
- The Loan Market Association released a note on the Revised Replacement of Screen Rate Clause and considerations related to credit adjustment spreads here.
- BMW become the first corporate issue to issue a floating rate note using Sonia as its benchmark. Article is available here.
- UK SONIA-linked covered bonds have remained stable, in contrast to euro denominated UK covered bonds amid rising expectation of a hard Brexit. Article is available here.
- UK Working Group on Risk-Free Reference Rates, Market Infrastructure Sub-Group updated priority list with regard to infrastructure developments for the RFR transition. Article is available here.

European Union
- European Central Bank Working Group meeting held on August 29, 2019 however meeting minutes have not been published yet.
- Buy-side faces operational risks if they don’t prepare for Libor transition article available here.
- The European Central Bank Working Group held their second roundtable which focused on providing information to market participants on how to transition from EONIA to the €STR. The agenda is available here.
- The European Bank for Reconstruction and Development issued its debut deal linked to SOFR. The article is available here.
- EURIBOR futures spread spikes and raises concerns about its unusual volatility. The article is available here.
- Report by the European Central Bank Working Group on Euro Risk-Free Rates on “The Impact of the Transition from EONIA to the €STR on Cash and Derivatives Products” is available here. The press release is available here.
- ICE Benchmark administrator consults on plan to reduce non-publication and prepare for transition to RFRs. Article is available here.

Japan
- Bank of Japan published an English version of the “August 1, 2019 Interest Rate Benchmark Reform Forum” here.
- The Task Force on Japanese Yen Interest Rate Benchmarks held its first meeting on August 28, 2019 and the agenda is available here.
System Requirements for SOFR FRN Conventions
When considering the different variations of conventions the bank may use for FRNs, banks may want to consider if their systems contain the appropriate functionalities in order to calculate the various types of SOFR conventions (e.g. Compounded Average SOFR in arrears, Simple Average SOFR, etc.) and assess the investment required to incorporate compound interest calculations. Banks may also consider confirming that the conventions used are sufficiently represented in the market so the FRNs can be easily understood by other market participants.

Understanding the Difference between Fallback Language for Bilateral Loans and Syndicated Loans
Both the syndicated and bilateral loans consultation provides for an amendment approach and a hardwired approach to fallback language. It is important to understand the slight variations applied to bilateral versus syndicated loans when using these approaches as well as determine if the "hedged loan approach" should be applied for hedged bilateral loans. This approach may be of interest to market participants who value consistency between the fallbacks for loans and swaps, but it is important to consider other costs and mismatches that may result between loans and related hedges.

Considering IPV
The CME’s big bang approach is aimed to facilitating the growth of the SOFR swap market to promote liquidity and the transition. This may likely help facilitate the transition to SOFR, but firms may want to consider IPV in order to confirm that their positions came out value neutral.